OFFICE OF THE POLICE AND CRIME COMMISSIONER
FOR HUMBERSIDE
DECISION RECORD

Decision Record Number: **11/2016**

Title: **Treasury Management Strategy Statement 2016/17**

Executive Summary: A copy of the Treasury Management Strategy Statement was submitted. It had been considered by the Joint Independent Audit Committee on 11.03.16 and recommended to the Commissioner for approval.

Decision: That the Treasury Management Strategy Statement for 2016/17 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 Grove	**Date 21.03.16**

Joint Independent Audit Committee
11 March 2016

Agenda Item 15
Report of the Deputy Chief Executive and Treasurer

TREASURY MANAGEMENT STRATEGY STATEMENT 2016/17

PURPOSE OF THE REPORT

1. This report introduces the draft Treasury Management Strategy Statement (TMSS) which is a requirement of the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 and supporting guidance. Local authorities are required to have regard to both the CLG guidance and the CIPFA Code.

2. The Police and Crime Commissioner (PCC) is required to approve the TMSS prior to the start of the new financial year and he has requested that it should be considered by this Committee prior to the final submission for approval.

BACKGROUND

3. The Prudential Code for Capital Finance in Local Authorities (the Prudential Code) underpins the system of capital finance. It allows local authorities, including police and crime commissioners, to determine their own programmes for capital investment. The Prudential Code has been developed as a professional code of practice to support this decision making process. Local authorities and PCCs are required by Regulation to have regard to the Prudential Code when carrying out their duties in accordance with the Local Government Act 2003.

4. The objectives of the Code are to ensure that when decisions on strategic planning, asset management and capital investment are made authorities, including PCCs, operate within a clear framework to satisfy themselves that investment plans are considered affordable, prudent and sustainable and that treasury management decisions are taken in accordance with good professional practice. To demonstrate that these objectives have been fulfilled the Code sets out indicators that must be used and the factors that must be taken into account. It does not however suggest individual limits, these are matters for local authorities and PCCs themselves.

5. Prudential indicators required by the Code are designed to support and record local decision making in a manner that is publicly accountable.

6. The Code sets out a clear guidance procedure for setting and revising prudential indicators. These indicators have to be set by the PCC who sets the budget. Prudential Indicators must be determined and approved before the start of the financial year and reflect budget decisions.

7. The guidance indicates that: priority should be given to security and liquidity as opposed to yield. It also recommends that investment strategies are considered at the start of each year. Revised strategies can be submitted at other times if changing circumstances mean that changes are required. Strategies should be published. It must be noted that local authorities, including PCCs, should not rely just on credit ratings but should also consider other information on credit risk. Strategies should comment on the use of treasury management consultants and also comment on money borrowed in advance of spending needs.

8. Treasury management consultants, Capita Asset Services are in the final year of a three year contract with an option to extend following a joint tender exercise between the South Yorkshire Joint Secretariat and the PCC for Humberside. Following the demise of the Joint Secretariat, and as previously reported, the Humberside Police and Crime Commissioner taking over the role of providing the treasury management function for the PCC for South Yorkshire the advisers have provided a quotation for a combined service and the contract has been extended to 31 August 2018.

9. Representatives of Capita Treasury Solutions have provided training on treasury management to the PCC and DPCC and some members of this Committee. Further training will be provided as part of the learning and development plan being considered by the Committee.

10. The TMSS for 2015/16 was approved by the PCC in March 2015, including a policy statement.

11. The Treasury Management Policy Statement is set out below and this remains unaltered:-

- *Treasury management activities are defined as:-*

  'The management of the organisation's cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks'

- *The PCC regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its 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. He is therefore committed to the principles of achieving best value in treasury management, and to employing suitable performance measurement techniques, within the context of effective risk management.*

12. The Treasury Management Strategy Statement (TMSS) for 2016/17 is based upon Capita Asset Services' recommended format.

INFORMATION

13. The draft Treasury Management Strategy Statement for 2016/17 is attached at Appendix 1. Adoption of this Statement will bring the PCC into line with best practice once again.

OPTIONS, RISKS AND OPPORTUNITIES

14. The Treasury Management Code applies to all organisations that have adopted it within formal policy documents and the PCC must have regard to it and CLG guidance in relation to local government investments.

15. The PCC is required to agree a Treasury Management Policy Statement and to have set out details of Treasury Management Practices in place to manage day to day activities.

16. The draft TMSS provides detailed information in relation to risks associated with treasury management activity and proposed mitigating actions. It acknowledges that the risk cannot be entirely eliminated but the Statement and the procedures detailed within it are intended to limit the PCC's exposure to unforeseen and unbudgeted financial consequences of treasury management activity.

POLICING PLAN AND PERFORMANCE

17. Effective treasury management arrangements are an important factor in ensuring that the Force and the OPCC operate efficiently and seek to contribute to the delivery of the Police and Crime Plan by seeking to make the best use of resources.

IMPACTS OR LINKS WITH COLLABORATION

18. As indicated above, the PCC is now carrying out the treasury management function for the PCC for South Yorkshire as part of the increasingly close collaboration between the two Commissioners and Forces.

FINANCIAL IMPLICATIONS

19. The report sets out details of the steps being taken to ensure that the PCC operates within a clear framework in relation to its treasury management activity both in relation to lending and borrowing.

20. The Prudential Indicator for Capital Expenditure is supported by detailed information on the capital programme set out in the Medium Term Resources Strategy (MTRS) 2016/17-2020/21 that supported the PCC's proposal to increase the precept for 20116/17.

21. The MTRS and report on the precept proposal were considered by the Police and Crime Panel on 5 February 2016. The proposal was unanimously supported by the Panel.

22. There are no immediate financial implications in relation to the issues raised within this report however the financial consequences of treasury management activity generally are very significant and have been factored into the budget and financial forecasts within the MTRS. This information will be updated as the year progresses.

LEGAL IMPLICATIONS

23. The PCC is required to comply with the requirements of the Local Government Act 2003 and to have regard to both the CLG guidance and the CIPFA Code when determining treasury management policy and strategies and detailed practices.

EQUALITY AND DIVERSITY AND HUMAN RIGHTS

24. There is no direct impact on equality and diversity and human rights as a result of this report.

RECOMMENDATIONS

24. It is recommended that:-

a) Members consider the issues raised in this report and endorse the Treasury Management Strategy Statement 2016/17, and
b) the PCC should approve the final version of the Treasury Management Strategy Statement for 2016/17 that will be effective from 1 April 2016.

J BATES
Deputy Chief Executive and Treasurer

Background Papers: Treasury Management Policy – File ref: JB/TMSS/2016/17

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POLICE AND CRIME COMMISSIONER FOR HUMBERSIDE

Treasury Management Strategy Statement 2016/17

Minimum Revenue Provision Policy Statement and Annual Investment Strategy

CONTENTS

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.

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

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 policies, estimates and actuals.

Prudential and treasury indicators and treasury strategy (this report) - The first, and most important report 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 of the capital position, amending prudential indicators as necessary, and 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.

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

1.3 Treasury Management Strategy for 2016/17

The strategy for 2016/17 covers two main areas:

Capital issues

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

Treasury management issues

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

These elements cover the requirements of the Local Government Act 2003, the CIPFA Prudential Code, 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 members with responsibility for treasury management receive adequate training in treasury management. This especially applies to members responsibe for scrutiny. The PCC, Deputy PCC, JIAC members and senior staff have received briefings from Capita Asset Services. Further training will be organised following the Elections for Police and Crime Commissioners in May and will be included in member training and development plan.

The training needs of treasury management officers are periodically reviewed along with opportunities to attend treasury management conferences and seminars arranged throughout the year by external organisations.

1.5 Treasury management consultants

The PCC uses Capita Asset Services, Treasury solutions as its external treasury management advisors.

The PCC recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon 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 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 2016/17 – 2020/21

The PCC's capital expenditure plans are the key driver of treasury management activity. The output of the capital expenditure plans is reflected in the prudential indicators, which are designed to assist the PCC's and the JIAC members' in overviewing and confirming capital expenditure plans.

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:

Capital expenditure £m	2014/15 Actual	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
Total	**9.236**	**3.596**	**13.819**	**6.658**	**4.907**

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.

Capital expenditure £m	2014/15 Actual	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
Total	**9.236**	**3.596**	**13.819**	**6.658**	**4.907**
Financed by:					
Capital receipts	0.511	0.878	-	-	-
Capital grants	2.672	1.361	1.078	1.078	1.104
Capital reserves	-	-	-	-	-
Revenue	0.037	-	-	0.005	0.095
Net financing need for the year	**6.016**	**1.357**	**12.741**	**5.575**	**3.708**

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 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 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 asset's life.

The PCC is asked to approve the CFR projections below:

£m	2014/15 Actual	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
Capital Financing Requirement					
Total CFR	**60.849**	**59.587**	**68.671**	**70.202**	**69.260**
Movement in CFR	**3.765**	**(1.262)**	**9.084**	**1.531**	**(0.942)**

Movement in CFR represented by					
Net financing need for the year (above)	6.016	1.357	12.741	5.575	3.708
Less MRP/VRP and other financing movements	2.251	2.619	3.657	4.044	4.650
Movement in CFR	**3.765**	**(1.262)**	**9.084**	**1.531**	**(0.942)**

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 it is also allowed to undertake additional voluntary payments if required (voluntary revenue provision - VRP).

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 authorities, so long as there is a prudent provision.

The PCC is recommended to approve the following MRP Statement:

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

- **Existing practice** - MRP will follow the existing practice outlined in former CLG regulations (option 1) - This provides for an approximate 4% reduction in the borrowing need (CFR) each year.

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

- **Asset life method** – MRP will be based on the estimated life of the assets, in accordance with the regulations (this option must be applied for any expenditure capitalised under a Capitalisation Direction) (option 3) - This option provides for a reduction in the borrowing need over approximately the asset's life.

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.). Detailed below are estimates of the year end balances for each resource and anticipated day to day cash flow balances.

Year End Resources £m	2014/15 Actual	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
Expected investments	**9.955**	**2.061**	**1.000**	**1.000**	**1.000**

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.

%	2014/15 Actual	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
Ratio	1.80	2.17	2.85	3.25	3.71

The estimates of financing costs include current commitments and the proposals in this budget report.

2.7 Incremental impact of capital investment decisions on council tax

This indicator identifies the revenue costs associated with proposed changes within the next three years as reflected in the five year capital programme included within the MTRS. The assumptions are based on the budget, but will invariably include some estimates, such as the level of Government support, which are not published over a three year period.

Incremental impact of capital investment decisions on the band D council tax

£	2014/15 Actual	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
Council tax - band D	3.64	2.02	3.16	2.32	0.93

3. BORROWING

The capital expenditure plans set out in Section 2 provide details of the PCC's activities. 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 these activities. 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 at 31 March 2015, 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.

£m	2014/15 Actual	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
External Debt					
Debt at 1 April	30.432	34.986	31.948	40.467	46.851
Expected change in Debt	4.554	(3.038)	8.519	6.384	4.713
Other long-term liabilities (OLTL)	0.588	0.294	-	-	-
Expected change in OLTL	(0.294)	(0.294)	-	-	-
Actual gross debt at 31 March	**35.280**	**31.948**	**40.467**	**46.851**	**51.564**
The Capital Financing Requirement	**60.849**	**59.587**	**68.671**	**70.202**	**69.260**
Under / (over) borrowing	**25.569**	**27.639**	**28.204**	**23.351**	**17.696**

Within the prudential indicators there are a number of key indicators to ensure that the PCC operates its activities within well-defined limits. One of these is that the PCC needs 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 2016/17 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 Treasurer reports that the PCC has complied with this prudential indicator in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans, and the proposals in this budget report.

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. In most cases, this would be a similar figure to the CFR, but may be lower or higher depending on the levels of actual debt.

Operational boundary £m	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
Total	68.141	68.260	65.410	65.410

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

1. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003. The Government retains an option to control either the total of all authorities' plans, or those of a specific authority, although this power has not yet been exercised.
2. The PCC is asked to approve the following authorised limit:

Authorised limit £m	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
Total	70.141	70.260	67.410	67.410

3.3 Prospects for interest rates

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

	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19
Bank rate	0.50%	0.50%	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%	1.25%	1.50%	1.50%	1.75%	1.75%
5yr PWLB rate	2.00%	2.10%	2.20%	2.30%	2.40%	2.50%	2.60%	2.70%	2.80%	2.90%	3.00%	3.10%	3.20%
10yr PWLB rate	2.60%	2.70%	2.80%	2.90%	3.00%	3.10%	3.20%	3.30%	3.40%	3.50%	3.60%	3.60%	3.70%
25yr PWLB rate	3.40%	3.40%	3.50%	3.60%	3.70%	3.70%	3.80%	3.90%	4.00%	4.00%	4.10%	4.10%	4.10%
50yr PWLB rate	3.20%	3.20%	3.30%	3.40%	3.50%	3.60%	3.70%	3.80%	3.90%	3.90%	4.00%	4.00%	4.00%

UK. UK GDP growth rates in 2013 of 2.2% and 2.9% in 2014 were the strongest growth rates of any G7 country; the 2014 growth rate was also the strongest UK rate since 2006 and although the 2015 growth rate was likely to be a leading rate in the G7 again, it looks likely to disappoint previous forecasts coming in at about 2.2%. Quarter 1 of 2015 was weak at +0.4% (+2.9% y/y) though there was a slight increase in quarter 2 to +0.5% (+2.3% y/y) before weakening again to +0.4% (2.1% y/y) in quarter 3 followed by a slight recovery in quarter 4 to an initial reading of +0.5%.
The February Bank of England Inflation Report included a forecast for growth to remain around 2.2 – 2.4% over the next three years, driven mainly by strong consumer demand as the squeeze on the disposable incomes of consumers has been reversed by a recovery in wage inflation at the same time that CPI inflation has fallen to, or near

to, zero since February 2015. However, these forecasts are approximately 0.2% lower than those of the November Inflation Report Investment expenditure is also expected to support growth. However, since the second half of 2015, most worldwide economic statistics have been weak and financial markets have been particularly volatile. The November Inflation Report flagged up particular concerns for the potential impact of these factors on the UK and this theme was maintained in the February Inflation Report.

The February Inflation Report was notably subdued in respect of the forecasts for inflation in the near-term; this was expected to barely get back up to the 1% level within the next 12 months but was expected to marginally exceed the 2% target on the 2-3 year time horizon. The increase in the November Inflation Report forecast for inflation at the three year horizon was the biggest in a decade and at the two year horizon was the biggest since February 2013. However, the first round of falls in oil, gas and food prices over late 2014 and also in the first half 2015, will fall out of the 12 month calculation of CPI during late 2015 / early 2016 but a second, more recent round of falls in fuel and commodity prices will delay a significant tick up in inflation from around zero. There is, therefore, considerable uncertainty around how quickly pay and CPI inflation will rise in the next few years and this makes it difficult to forecast when the MPC will decide to make a start on increasing Bank Rate. There is also the uncertain impact of the EU referendum which will take place as early as June 2016.

The weakening of UK GDP growth during 2015 and the deterioration of prospects in the international scene, especially for emerging market countries, have consequently led to forecasts for when the first increase in Bank Rate would occur being pushed back to quarter 4 of 2016. There is downside risk to this forecast i.e. it could be pushed further back and the markets are currently betting on a mid 2017 increase.

USA. The American economy made a strong comeback after a weak first quarter's growth at +0.6% (annualised), to grow by no less than 3.9% in quarter 2 of 2015, but then pulled back to 2.0% in quarter 3 and retreated to +0.7% in quarter 4. However, the uninterrupted run of strong monthly increases in non-farm payrolls figures for growth in employment in 2015 prepared the way for the Fed. to embark on its long awaited first increase in rates of 0.25% at its December meeting. However, the accompanying message with this first increase was that further increases will be at a much slower rate, and to a much lower ultimate ceiling, than in previous business cycles, mirroring comments by our own MPC.

EZ. In the Eurozone, the ECB fired its big bazooka in January 2015 in unleashing a massive €1.1 trillion programme of quantitative easing to buy up high credit quality government and other debt of selected EZ countries. This programme of €60bn of monthly purchases started in March 2015 and it was intended to run initially to September 2016. At the ECB's December meeting, this programme was extended to March 2017 but was not increased in terms of the amount of monthly purchases. The ECB also cut its deposit facility rate by 10bps from -0.2% to -0.3%. This programme of monetary easing has had a limited positive effect in helping a recovery in consumer and business confidence and a start to some improvement in economic growth. GDP growth rose to 0.5% in quarter 1 2015 (1.3% y/y) but has then eased back to +0.4% (+1.6% y/y) in quarter 2 and to +0.3% (+1.6%) in quarter 3.

Financial markets were disappointed by the ECB's lack of more decisive action in December and it is likely that it will need to boost its QE programme if it is to succeed in significantly improving growth in the EZ and getting inflation up from the current level of around zero to its target of 2%.

Greece. During July, Greece finally capitulated to EU demands to implement a major programme of austerity and is now cooperating fully with EU demands. An €86bn third bailout package has since been agreed though it did nothing to address the unsupportable size of total debt compared to GDP. However, huge damage has been done to the Greek banking system and economy by the resistance of the Syriza Government, elected in January, to EU demands. The surprise general election in September gave the Syriza government a mandate to stay in power to implement austerity measures. However, there are major doubts as to whether the size of cuts and degree of reforms required can be fully implemented and so Greek exit from the euro may only have been delayed by this latest bailout.

Portugal and Spain. The general elections in September and December respectively have opened up new areas of political risk where the previous right wing reform-focused pro-austerity mainstream political parties have lost their majority of seats. An anti-austerity coalition has won a majority of seats in Portugal while the general election in Spain produced a complex result where no combination of two main parties is able to form a coalition with a majority of seats. It is currently unresolved as to what administrations will result from both these situations. This has created nervousness in bond and equity markets for these countries which has the potential to spill over and impact on the whole Eurozone project.

- Investment returns are likely to remain relatively low during 2016/17 and beyond;
- Borrowing interest rates have been highly volatile during 2015 as alternating bouts of good and bad news have promoted optimism, and then pessimism, in financial markets. Gilt yields have continued to remain at historically phenominally low levels during 2015. The policy of avoiding new borrowing by running down spare cash balances, has served well over the last few years. However, this needs to be carefully reviewed to avoid incurring higher borrowing costs in later times, when authorities will not be able to avoid new borrowing to finance new capital expenditure and/or to refinance maturing debt;
- There will remain a cost of carry to any new borrowing which causes an increase in investments as this will incur a revenue loss between borrowing costs and investment returns.

3.4 Borrowing strategy

The PCC is currently maintaining 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 2016/17 treasury operations. The Treasuer 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 an acceleration in the start date and in the rate of increase in central rates in the USA and UK, an 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 are still lower than they will be in the next few years.

Any decisions will be reported to the PCC at the next available opportunity.

Treasury management limits on activity

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

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

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

£m	2016/17	2017/18	2018/19
Interest rate exposures			
	Upper	**Upper**	**Upper**
Limits on fixed interest rates based on net debt	69.000	66.000	66.000
Limits on variable interest rates based on net debt	34.000	33.000	33.000
Limits on fixed interest rates:			
• ***Debt only***	70.000	67.000	67.000
• ***Investments only***	-	-	-
Limits on variable interest rates			
• ***Debt only***	35.000	34.000	34.000
• ***Investments only***	50.000	50.000	50.000

Maturity structure of fixed interest rate borrowing 2016/17		
	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%
Maturity structure of variable interest rate borrowing 2016/17		
	Lower	Upper
Under 12 months	0%	0%
12 months to 2 years	0%	0%
2 years to 5 years	0%	0%
5 years to 10 years	0%	0%
10 years and above	0%	0%

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 meeting following its action.

3.7 Municipal Bond Agency

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

4. ANNUAL INVESTMENT STRATEGY

Introduction: changes to credit rating methodology

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

In keeping with the agencies' new methodologies, the rating element of our own credit assessment process now focuses solely on the Short and Long Term ratings of an institution. While this is the same process that has always been used for Standard & Poor's, this has been a change in the use of Fitch and Moody's ratings. It is important to stress that the other key elements to our process, namely the assessment of Rating Watch and Outlook information as well as the Credit Default Swap (CDS) overlay have not been changed.

The evolving regulatory environment, in tandem with the rating agencies' new methodologies also means that sovereign ratings are now of lesser importance in the assessment process. Where through the crisis, clients typically assigned the highest sovereign rating to their criteria, the new regulatory environment is attempting to break the link between sovereign support and domestic financial institutions. While this authority understands the changes that have taken place, the PCC has agreed that investments will only be made in UK counterparties.

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

4.1 Investment policy

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

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

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

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

Investment instruments identified for use in the financial year are listed in appendix 5.1 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 Capita Asset Services. 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:

- Yellow 5 years
- Dark pink 5 years for Enhanced money market funds (EMMFs) with a credit score of 1.25
- Light pink 5 years for Enhanced money market funds (EMMFs) with a credit score of 1.5
- Purple 2 years
- Blue 1 year (only applies to nationalised or semi nationalised UK Banks)
- Orange 1 year
- Red 6 months
- Green 100 days
- No colour not to be used

Y	Pi1	Pi2	P	B	O	R	G	N/C
1	1.25	1.5	2	3	4	5	6	7
Up to 5yrs	Up to 5yrs	Up to 5yrs	Up to 2yrs	Up to 1yr	Up to 1yr	Up to 6mths	Up to 100days	No Colour

	Colour (and long term rating where applicable)	Time Limit
Banks	yellow	5yrs
Banks	purple	2 yrs
Banks	orange	1 yr
Banks – part nationalised	blue	1 yr
Banks	red	6 mths
Banks	green	100 days
Banks	No colour	N/A
DMADF	AAA	6 months
Local authorities	n/a	364 days
	Fund rating	**Time Limit**
Money market funds	AAA	liquid
Enhanced money market funds with a credit score of 1.25	Dark pink / AAA	liquid
Enhanced money market funds with a credit score of 1.5	Light pink / AAA	liquid

The Capita Asset Services' creditworthiness service uses a wider array of information than just primary ratings. Furthermore, by using a risk weighted scoring system, it 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 F1 and a Long Term rating of A-. 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 Capita Asset Services' 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 PCC will be advised of information in movements in credit default swap spreads against the iTraxx benchmark and other market data on a daily basis via its Passport website, provided exclusively to it by Capita Asset Services. 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. In addition to this the PCC will also use market data and market information, information on any external support for banks to help support its decision making process.

4.3 Country and sector limits

The PCC has determined that he will only use 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 4 of 2016. Bank Rate forecasts for financial year ends (March) are:

- 2016/17 0.75%
- 2017/18 1.25%
- 2018/19 1.75%

The following forecasts of investment earnings rates for returns on investments placed for periods up to 100 days during each financial year are as follows:

2016/17 0.60%
2017/18 1.25%
2018/19 1.75%
2019/20 2.25%
2020/21 2.50%
2021/22 2.75%
2022/23 2.75%
2023/24 3.00%
Later years 3.00%

The overall balance of risks to these forecasts is currently to the downside (i.e. start of increases in Bank Rate occurs later). However, should the pace of growth quicken and / or forecasts for increases in inflation rise, there could be an upside risk.

Investment treasury indicator and limit – The PCC has agreed that funds can only be invested for up to 364 days.

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

4.5 Icelandic bank investments

All treasury management reports will provide an update on the action being taken to recover monies invested with the subsidiaries of Heritable Bank and Kaupthing Singer and Friedlander (KSF) which failed in 2008.

4.6 Investment risk benchmarking

The PCC will use the average 7 day LIBID rate as the investment benchmark to assess the performance of the portfolio.

4.7 Investment reports

At the end of the financial year, the PCC will issue a report on the investment activity as part of its Annual Treasury Report. During the year information is made available to JIAC members from monthly investment reports.

5. APPENDICES

1. Treasury management practice 1 – credit and counterparty risk management
2. Treasury management scheme of delegation
3. The treasury management role of the section 151 officer

5.1 APPENDIX: 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.

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	N/A	100%/No limit	6 months
UK Government gilts	UK sovereign rating	100%/No limit	12 months
UK Government Treasury bills	UK sovereign rating	100%/No limit	12 months
Money market funds	AAA	100%/£10m	Liquid
Enhanced money market funds with a credit score of 1.25	AAA	100%	Liquid
Enhanced money market funds with a credit score of 1.5	AAA	100%	Liquid
Local authorities	N/A	100%	12 months
Term deposits with banks and building societies	Blue } Orange } Red } Green No Colour	£15m £10m	12 months 12 months 6 months 100 days Not for use

5.2 APPENDIX: Treasury management scheme of delegation

(i) Police and Crime Commissioner

- receiving and reviewing reports on treasury management policies, practices and activities;
- approval of annual strategy;
- approval of/amendments to the organisation's adopted clauses, treasury management policy statement and treasury management practices;
- budget consideration and approval;
- approval of the division of responsibilities;
- receiving and reviewing regular monitoring reports and acting on recommendations and
- approving the selection of external service providers and agreeing terms of appointment.

(ii) Joint Independent Audit Committee

- reviewing the treasury management policy and procedures and making recommendations to the PCC.

5.3 APPENDIX: 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.