OFFICE OF THE POLICE AND CRIME COMMISSIONER
FOR HUMBERSIDE
DECISION RECORD

Decision Record Number: **06/2017**

Title: **Treasury Management Strategy Statement 2017/18**

Executive Summary:

A copy of the Treasury Management Strategy Statement (TMSS) was submitted for consideration by the PCC. The TMSS provides details of the. ~~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).

Decision:

(a) That the Treasury Management Strategy Statement for 2017/18 be approved and

(b) That in view of the incremental impact of capital investment decisions further regular reports should be provided on the detailed capital programme and progress in implementing the proposed spending plans during the financial year.

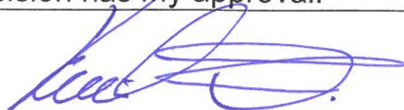
Background Report: Open

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  **Date 06.03.17**

Police and Crime Commissioner for Humberside

Treasury Management Strategy Statement 2017/18

Minimum Revenue Provision Policy Statement and Annual Investment Strategy

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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 down 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 on the capital position; provide information on any proposals to amend prudential indicators and whether treasury management activities are meeting the strategy together with any amendments to the strategy or policies.

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.

When it is operational, the above reports will be scrutinised by the Joint Independent Audit Committee (JIAC) before being recommended to the PCC. In the absence of the Committee, reports will be presented directly to the PCC for consideration and approval.

1.3 Treasury Management Strategy for 2017/18

The strategy for 2017/18 covers two main areas:

Capital issues

- the capital plans and the prudential indicators, and
- 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 the 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 responsible for scrutiny. Training is in the process of being organised for the PCC, newly appointed JIAC members and senior OPCC staff.

The training needs of the treasury management officers are reviewed periodically.

1.5 Treasury management consultants

The PCC uses Capita Asset Services 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 on external service providers.

It is recognised 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 2017/18 – 2019/20

The PCC's capital expenditure plans are the key driver of treasury management activity. The output of the capital programme is reflected in the prudential indicators, which are designed to provide an overview and confirm 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 the latest budget cycle.

Capital expenditure £m	2015/16 Actual	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate
Total	**4.627**	**6.856**	**16.043**	**13.715**	**4.513**

The table below summarises the above capital expenditure plans and how they are intended to be financed by capital or revenue resources. Any shortfall of resources results in a borrowing need:

Capital expenditure £m	2015/16 Actual	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate
Total	**4.627**	**6.856**	**16.043**	**13.715**	**4.513**
Financed by:					
Capital receipts	1.243	1.400	-	-	-
Capital grants	1.695	0.822	0.698	0.697	0.697
Capital reserves	-	-	-	-	-
Revenue	-	-	-	-	-
Net financing need for the year	**1.689**	**4.634**	**15.345**	**13.018**	**3.816**

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 CFR projections for the PCC are set out below:

£m	2015/16 Actual	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate
Capital Financing Requirement					
Total CFR	**59.933**	**61.879**	**73.956**	**82.869**	**81.799**
Movement in CFR	**(0.916)**	**1.946**	**12.077**	**8.913**	**(1.070)**

Movement in CFR represented by					
Net financing need for the year (above)	1.689	4.634	15.345	13.018	3.816
Less MRP	2.605	2.688	3.268	4.105	4.886
Movement in CFR	**(0.916)**	**1.946**	**12.077**	**8.913**	**(1.070)**

3 BORROWING

The capital expenditure plans set out in Section 2 provide details of the service activity of the PCC. The treasury management function ensures that the PCC's cash is organised in accordance with the 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 at 31 March 2016, with forward projections is 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	2015/16 Actual	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate
External Debt					
Debt at 1 April	34.986	31.947	29.207	42.126	51.740
Repayment of Debt	(3.039)	(2.740)	(2.426)	(3.404)	(3.411)
Forecast new Debt	-	-	15.345	13.018	3.816
Other long-term liabilities	-	-	-	-	-
Actual gross debt at 31 March	**31.947**	**29.207**	**42.126**	**51.740**	**52.145**
The Capital Financing Requirement	**59.933**	**61.879**	**73.956**	**82.869**	**81.799**
Under / (over) borrowing	**27.986**	**32.672**	**31.830**	**31.129**	**29.654**

Within the prudential indicators there are a number of key indicators to ensure that the PCC operates 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 2017/18 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 confirms 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 the 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.

Operational boundary £m	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate
Total	81.523	80.799	76.476	71.831

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. It should be noted that the Government retains an option to control either the total of all PCC's plans, or those of a specific PCC, although this power has not yet been exercised.
2. The PCC is asked to approve the following authorised limit:

Authorised limit £m	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate
Total	83.523	82.799	78.476	73.831

3.3 Prospects for interest rates

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

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

From the Bank of England's quarterly Inflation Report o 2 February 2017, Capital Asses Services identified a number of key points:-

- An increase in the forecast for GDP growth for 2017 from 1.4% to 2.0% and for 2018 from 1.5% to 1.6%, indicating the UK economy has been, and is likely to be, much more resilient to the effects of Brexit uncertainty than had been previously expected. The Bank quoted the easing of the fiscal squeeze and stronger global economic data in its latest reasoning.
- Little change in inflation forecasts though there were comments around the £ strengthening in value somewhat over the last quarter.

- The equilibrium rate of unemployment was reduced from 5.0% to 4.5%. This potentially means that the MPC could wait longer before taking action to combat rising inflation.
- Some MPC members were clearly more concerned about the degree to which they could look through increases in inflation caused by the effective devaluation of the £ since the referendum and the consequent feed through into the CPI measure of inflation.

The robust forecast for growth for 2017 has raised questions from some commentators as to whether the emergency cut in Bank Rate from 0.50% to 0.25%, and a new programme of quantitative easing (QE), was still warranted i.e. whether they should be reversed. (The UK turned in the strongest GDP growth of any G7 country in 2016 at 2.0% y/y despite the forecast in the August Inflation Report that GDP growth would be nearly zero in the second half of 2016.) Clearly, the MPC decided that such a reversal was not warranted at the current time and there are still some concerns as to whether the potential downside effects of Brexit have only been delayed. Capita's forecasts assume that there is no such cancellation of the emergency cut and a stop to the QE programme in the shorter term. There is a potential risk that the MPC could muster a majority to reverse both before reaching a time when there is a progression to a sustained trend of gentle increases in Bank Rate.

The House of Commons has concluded the committee stage of considering the White Paper on Article 50 for the UK to leave the EU. This is now in the process of going through the House of Lords.

Capita's overall view is that there is now upside risk to their interest rate forecasts if GDP growth and the rate of growth of inflation, and its peak, are stronger than currently forecast. It is felt that the MPC will focus on inflation risks ahead of protecting growth if inflation looks like rising to levels significantly above current forecasts. However it is very difficult to be at all certain about risks around this, especially when currency movements in the £, $ and Euro will be very hard to predict and are subject to major unknowns.

Another commentator, Capital Economics' forecasts for UK economic growth are as follows: 2017 +1.8%; 2018 +2.5%. They feel that the Bank is still overdoing pessimism and Brexit will not have as big an effect as initially feared by some commentators.

One major uncertainty is the degree to which there will be a major financial stimulus programme in the US - depending on the degree of agreement, or otherwise, between President Trump and Congress. If this stimulus programme is substantial, this is likely to have, in turn, a significant impact on the rise in inflation pressures and the speed of increases in the Fed Funds rate. There are also concerns as to whether the US will enter into a trade and currency value conflict with other major trading nations. The value of the $ against other currencies has been subject to major volatility since the Presidential election and this is likely to continue.

In addition to the issues described above, there are also a significant number of rising EU and geopolitical risks.

Capita Asset Services maintain the view that economic forecasting remains difficult with so many external influences weighing on the UK. Their Bank Rate forecasts, (and also MPC decisions), will be liable to further amendment depending on how economic data and developments in financial markets transpire over the next year. Forecasts for average earnings beyond the three year time horizon will be heavily dependent on economic and political developments. Major volatility in bond yields is likely to endure as investor fears and confidence ebb and flow between favouring more risky assets i.e. equities, or the safe haven of bonds.

The overall longer run trend is for gilt yields and PWLB rates to rise, albeit gently. An eventual world economic recovery may also see investors switching from the safe haven of bonds to equities.

Capita have pointed out consistently that the Fed. Funds Rate is likely to go up more quickly and more strongly than Bank Rate in the UK and recent events have not changed that view, just that the timing of such increases may well have been deferred somewhat during 2016. While there is normally a high degree of correlation between the two yields. It is expected that there will be a growing decoupling of yields i.e. with US yields expected to rise faster than UK yields. This will be closely monitored along with the resulting effect on PWLB rates.

- The overall balance of risks to economic recovery in the UK remains to the downside, particularly with the current uncertainty over the final terms of Brexit.

- The balance of risks to increases in Bank Rate and shorter maturity PWLB rates are to the upside and dependent on how quickly inflation pressures rise and how high the peak will be.

- Forecasts are predicated on an assumption that there is no break-up of the Eurozone or EU (apart from the departure of the UK), within the forecasting time horizon despite the major challenges that are looming up, and that are no major ructions in international relations, especially between the US and China, which have a major impact on international trade and world GDP growth.

As reported previously, PWLB rates and bond yields are presently very unpredictable with exceptional levels of volatility being experienced that are highly correlated to geo-political and sovereign debt crisis developments.

The forecasts are based on the Certainty Rate (minus 20 bps) which has been accessible to most authorities since 1st November 2012.

Downside risks to current forecasts for UK gilt yields and PWLB rates currently include:
- Geopolitical risks in Europe, the Middle East and Asia, which could lead to increasing safe haven flows.
- UK economic growth and increases in inflation are weaker than we currently anticipate.
- Weak growth or recession in the UK's main trading partners - the EU and US.
- A resurgence of the Eurozone sovereign debt crisis.
- Weak capitalisation of some European banks.
- Monetary policy action failing to stimulate sustainable growth and combat the potential threat of deflation in western economies.

The potential for upside risks to current forecasts for UK gilt yields and PWLB rates, especially for longer term PWLB rates include: -
- The pace and timing of increases in the Fed. Funds Rate causing a fundamental reassessment by investors of the relative risks of holding bonds as opposed to equities and leading to a major flight from bonds to equities.
- UK inflation returning to significantly higher levels causing an increase in the inflation premium inherent to gilt yields.

Investment and borrowing rates:

- Investment returns are likely to remain low during 2017/18 and beyond.
- Borrowing interest rates have been on a generally downward trend during most of 2016 up to mid-August; they fell sharply to historically phenomenally low levels after the referendum and then even further after the MPC meeting of 4 August when a new package of quantitative easing purchasing of gilts was announced. Gilt yields have since risen sharply due to a rise in concerns around a 'hard Brexit', the fall in the value of sterling, and an increase in inflation expectations. The policy of avoiding new borrowing by running down spare cash balances, has served well over the last few years. However, this needs to be carefully reviewed to avoid incurring higher borrowing costs in later times when authorities will not be able to avoid new borrowing to finance capital expenditure and/or to refinance maturing debt;
- There will remain a cost of carry to any new long-term borrowing that causes a temporary increase in cash balances as this position will, most likely, incur a revenue cost - the difference between borrowing costs and investment returns.

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 still an issue that needs to be considered.

Against this background and the risks within the economic forecast, caution will be adopted with the 2017/18 treasury operations. The Deputy Chief Executive 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 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. Most likely, fixed rate funding will be drawn whilst interest rates are lower than they are projected to be in the next few years.

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

3.5 Policy on borrowing in advance of need

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

Risks associated with any borrowing in advance of 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, and
- 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.

3.7 Municipal Bond Agency

The Municipal Bond Agency may be in a position at some stage to offer loans to local authorities at rates that are lower than Public Works Loan Board (PWLB) rates. The PCC intends to keep developments in this area under review and may make use of this new source of borrowing if and when appropriate.

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 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 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 the 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 5.4 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

The 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, and
- 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 will 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 on a monthly basis. 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 Capita Asset Services' Passport website. 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 the PCC will also use market data and market information, information from any external sources including from banks and brokers to help support its decision making process.

4.3 Country limits

The PCC has determined that it 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 stay flat at 0.25% until quarter 2 2019 and not to rise above 0.75% by quarter 1 2020. Bank Rate forecasts for financial year ends (March) are:

- 2016/17 0.25%
- 2017/18 0.25%
- 2018/19 0.25%
- 2019/20 0.75%

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

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

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

Investment treasury indicator and limit: The PCC has determined that total principal funds will not be invested for longer than 364 days.

For its cash flow generated balances, the PCC will seek principally to utilise business reserve, instant access and notice accounts together with short-dated deposits where appropriate.

4.5 Investment risk benchmarking

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

4.6 End of year investment report

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

5 APPENDICES

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

5.1 THE CAPITAL PRUDENTIAL AND TREASURY INDICATORS 2017/18 – 2019/20 AND MRP STATEMENT

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

5.1.1 Capital expenditure

Capital expenditure £m	2015/16 Actual	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate
Total	**4.627**	**6.856**	**16.043**	**13.715**	**4.513**

5.1.2 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 are allowed 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 PCCs, so long as there is a prudent provision.

The PCC's MRP Statement is as follows:

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, which provide for an approximate 4% reduction in the borrowing need (CFR) each year.

From 1 April 2008 for all unsupported borrowing (including 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 and any expenditure capitalised under a Capitalisation Direction.

5.1.3 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.

a Ratio of financing costs to net revenue stream

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

%	2015/16 Actual	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate
Ratio	2.10	2.15	2.80	3.41	3.96

The estimates of financing costs include current commitments and the proposals in the latest budget reports.

b Incremental impact of capital investment decisions on PCC Precept/Council Tax

This indicator identifies the revenue costs associated with proposed changes to the capital programme recommended in this budget report compared to the PCC's existing approved commitments and current plans. The assumptions are based on the latest budget reports, but will invariably include some estimates, such as the level of Government support, which are not published over a period for more than one year.

c Incremental of capital investment decisions on the band D PCC Precept/Council Tax

£	2015/16 Actual	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate
PCC Precept/ Council Tax - band D	1.96	(1.52)	3.89	1.79	3.55

5.1.4 Treasury indicators for debt

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, and
- 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 has adopted the following treasury indicators and limits:

£m	2017/18	2018/19	2019/20
Interest rate exposures			
	Upper	**Upper**	**Upper**
Limits on fixed interest rates based on net debt	82.000	77.000	73.000
Limits on variable interest rates based on net debt	41.000	39.000	37.000
Maturity structure of fixed interest rate borrowing 2017/18			
		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%

5.2 INTEREST RATE FORECASTS 2016 – 2020

PWLB forecasts are included within section 3.3 above.

5.3 ECONOMIC BACKGROUND

Following the latest Bank of England quarterly Inflation Report on 2 February, Capita Asset Services reviewed their forecasts from 14 November 2016 and decided that there are not any sufficiently different material factors to those already appraised to warrant a change to their forecasts.

PWLB rates today marginally below their forecasts for the end of March 2017 but are within the tolerances for volatility seen in recent weeks.

The key points from the latest Inflation Report were:-

- An increase in the forecast for GDP growth for 2017 from 1.4% to 2.0% and for 2018 from 1.5% to 1.6%, indicating the UK economy has been, and is likely to be, much more resilient to the effects of Brexit uncertainty than had been previously expected. The Bank quoted the easing of the fiscal squeeze and stronger global economic data in its latest reasoning.
- Little change in inflation forecasts though there were comments around the £ strengthening in value somewhat over the last quarter.
- The equilibrium rate of unemployment was reduced from 5.0% to 4.5%. This potentially means that the MPC could wait longer before taking action to combat rising inflation.
- Some MPC members were clearly more concerned about the degree to which they could look through increases in inflation caused by the effective devaluation of the £ since the referendum and the consequent feed through into the CPI measure of inflation.

The robust forecast for growth for 2017 has raised questions from some commentators as to whether the emergency cut in Bank Rate from 0.50% to 0.25%, and a new programme of quantitative easing (QE), was still warranted i.e. whether they should be reversed. (The UK turned in the strongest GDP growth of any G7 country in 2016 at 2.0% y/y despite the forecast in the August Inflation Report that GDP growth would be nearly zero in the second half of 2016.) Clearly, the MPC decided that such a reversal was not warranted at the current time and there are still some concerns as to whether the potential downside effects of Brexit have only been delayed. Although Capita's forecasts assume that there is no such cancellation of the emergency cut and a stop to the QE programme in the shorter term, there is a potential risk that the MPC could muster a majority to reverse both before reaching a time when there is a progression to a sustained trend of gentle increases in Bank Rate.

The House of Commons has concluded the committee stage of considering the White Paper on Article 50 for the UK to leave the EU and this is now being considered in the House of Lords. The timetable for Brexit is set out in detail below.

Brexit timetable and process

- March 2017: UK government notifies the European PCC of its intention to leave under the Treaty on European Union Article 50.

- March 2019: two-year negotiation period on the terms of exit. This period can be extended with the agreement of all members i.e. not that likely.

- UK continues as an EU member during this two-year period with access to the single market and tariff free trade between the EU and UK.

- The UK and EU would attempt to negotiate, among other agreements, a bi-lateral trade agreement over that period.
- The UK would aim for a negotiated agreed withdrawal from the EU, although the UK may also exit without any such agreements.
- If the UK exits without an agreed deal with the EU, World Trade Organisation rules and tariffs could apply to trade between the UK and EU - but this is not certain.
- On exit from the EU: the UK parliament would repeal the 1972 European Communities Act.
- The UK will then no longer participate in matters reserved for EU members, such as changes to the EU's budget, voting allocations and policies.

Capita's overall view is that there is now upside risk to their interest rate forecasts if GDP growth and the rate of growth of inflation, and its peak, are stronger than currently forecast. It is felt that the MPC will focus on inflation risks ahead of protecting growth if inflation looks like rising to levels significantly above current forecasts. However it is very difficult to be at all certain about risks around this, especially when currency movements in the £, $ and Euro will be very hard to predict and are subject to major unknowns.

Capital Economics' forecasts for UK economic growth are as follows: 2017 +1.8%; 2018 +2.5%. They feel that pessimism is still being overdone by the Bank and Brexit will not have as big an effect as initially feared by some commentators.

One major uncertainty is the degree to which there will be a major financial stimulus programme in the US - depending on the degree of agreement, or otherwise, between President Trump and Congress. If this stimulus programme is substantial, this is likely to have, in turn, a significant impact on the rise in inflation pressures and the speed of increases in the Fed Funds rate. There are also concerns as to whether the US will enter into a trade and currency value conflict with other major trading nations. The value of the $ against other currencies has been subject to major volatility since the Presidential election and this is likely to continue.

Rising EU and geopolitical risks e.g.
Greece continues to cause major stress in the EU due to its tardiness and reluctance in implementing key reforms required by the EU to make the country more efficient and to make significant progress towards the country being able to pay its way – and before the EU is prepared to agree to release further bail out funds. A crunch point is imminent this summer when Greece needs to make major repayments that it will not be able to make unless there is a new bail out, which is potentially unlikely ahead of the general election due in Germany before late October.
Spain has had two general elections in 2015 and 2016, both of which failed to produce a workable government with a majority of the 350 seats. At the eleventh hour on 31 October, before it would have become compulsory to call a third general election, the party with the biggest bloc of seats (137), was given a majority confidence vote to form a government. This is potentially a highly unstable situation, particularly given the need to deal with an EU demand for implementation of a package of austerity cuts which will be politically unpopular.
In Italy the under capitalisation of Italian banks poses a major risk with state aid firmly ruled out by the EU as a potential way out and the 4 December Italian constitutional referendum on reforming the Senate and reducing its powers; became a confidence vote on Prime Minister Renzi who duly resigned when he lost the vote. The rejection of these

proposals could stop progress to fundamental political and economic reform which is urgently needed to deal with Italy's core problems, especially low growth. They were also intended to give Italy more stable government as no western European country has had such a multiplicity of governments since the Second World War as Italy, due to the equal split of power between the two chambers of the Parliament which are both voted in by the Italian electorate but by using different voting systems. This means there is now major uncertainty about the road ahead for Italy.

Dutch general election 15 March 2017: a far right party is currently polling neck and neck with the incumbent ruling party. In addition, anti-big business and anti-EU activists have already collected two thirds of the 300,000 signatures required to force a referendum to be taken on approving the EU – Canada free trade pact. This could delay the pact until a referendum in 2018 which would require unanimous approval by all EU governments before it can be finalised. In April 2016, Dutch voters rejected by 61.1% an EU – Ukraine co-operation pact under the same referendum law. Dutch activists are concerned by the perceived lack of democracy in the institutions of the EU. The ability of just one nation among 27 nations in the post Brexit EU to halt progress on international agreements poses an identifiable risk to the UK in negotiations with the EU on the terms of Brexit.

French presidential election; first round 13 April; second round 7 May 2017.

French National Assembly election June 2017.

German Federal election August – 22 October 2017. This could be affected by significant shifts in voter intentions as a result of terrorist attacks, dealing with a huge influx of immigrants and a rise in anti EU sentiment.

The core EU, (note, not just the Eurozone currency area), principle of free movement of people within the EU is a growing issue leading to major stress and tension between EU states, especially with the Visegrad bloc of former communist states.

Given the number and type of challenges the EU faces over the next year or so, there is an identifiable risk for the EU project to be called into fundamental question. The risk of an electoral revolt against the EU establishment has gained traction after the shock results of the UK referendum and the US Presidential election. However it remains to be seen whether any shift in sentiment will gain sufficient traction to produce any further shocks.

Economic growth in the EU, (the UK's biggest trading partner), has been lack lustre for a long time despite the ECB cutting its main rate to -0.4% and embarking on a massive programme of quantitative easing during 2016, although growth has picked up more recently. Growth could be negatively impacted by political developments which would then also impact on UK exports and growth.

The US economy grew strongly in quarter three at 3.5%, (on an annualised basis), after only 1.1% in the first half of the year, but quarter 4 came in at only 1.9% after net trade reduced GDP by 1.7%. This left GDP growth in 2016 as a whole at 1.6%. Nevertheless, it is still widely expected that there will be three more interest rate rises in 2017 to lift the central rate to between 1.5% – 1.75%.

Japan is struggling to stimulate consistent significant growth, but the Bank of Japan, on 31 January, did upgrade its GDP growth forecast for the 2016 fiscal year from 1.0% to 1.4% and from 1.3% to 1.5% for 2017 on the grounds of improvements in overseas economies and the yen's depreciation. It is also struggling to get inflation up to its target of 2% despite huge monetary and fiscal stimulus. It is also making little progress on fundamental reform of the economy.

Chinese economic growth has been weakening despite successive rounds of central bank stimulus; medium term risks are increasing. Major progress still needs to be made to eliminate excess industrial capacity and the stock of unsold property, and to address the level of non-performing loans in the banking and credit systems.

5.4 TREASURY MANAGEMENT PRACTICE (TMP1) – CREDIT AND COUNTERPARTY RISK MANAGEMENT

SPECIFIED INVESTMENTS: All such investments will be sterling denominated, with **maturities up to maximum of 364 days**, 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%	Liquid
Enhanced Cash Funds with a credit score of 1.25	AAA	100%	Liquid
Enhanced Cash 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 £20m – with any one banking group	Blue } Orange } Red } Green No Colour	 £15m £20m	12 months 12 months 6 months 100 days Not for use

5.5 TREASURY MANAGEMENT SCHEME OF DELEGATION

(i) The 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) The Joint Independent Audit Committee (when Operational)

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

5.6 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.