



Cambridgeshire
Police & Crime
Commissioner

Treasury Management Strategy Statement

Minimum Revenue Provision Policy Statement
and Annual Investment Strategy

2015/16

May 2015

INDEX

1 INTRODUCTION

1.1 Background

The Commissioner 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 Commissioner'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 Commissioner's capital plans. These capital plans provide a guide to the borrowing need of the Commissioner, essentially the longer term cash flow planning to ensure that the Commissioner 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 Commissioner risk or cost objectives.

CIPFA defines treasury management as:

"The management of the local authority'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 Commissioner 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 members with the progress of the capital position, amending prudential indicators as necessary, and whether any policies require revision. In addition, this Commissioner will receive quarterly update reports.

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 Commissioner. This role is undertaken by the Audit Committee and Finance Sub Group.

1.3 Treasury Management Strategy for 2015/16

The strategy for 2015/16 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 Commissioner;
- 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 responsible for scrutiny.

The Police and Crime Commissioner (“the Commissioner”)/Deputy Police and Crime Commissioner (“the Deputy Commissioner”) and members of the substantive Joint Audit Committee will be provided with appropriate training.

The training needs of treasury management officers are periodically reviewed.

1.5 Treasury management consultants

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

The Commissioner recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon our external service providers.

It also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The Commissioner 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 2015/16 – 2017/18

The Commissioner'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.

2.1 Capital expenditure

This prudential indicator is a summary of the Commissioner's capital expenditure plans, both those agreed previously, and those forming part of this budget cycle. Members are asked to approve the capital expenditure forecasts:

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 £'000	2013/14 Actual	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate
Total	4,559	6,900	2,568	3,445	3,120
Financed by:					
Capital receipts	-	-	303	-	-
Capital grants	1179	1,205	987	987	987
Other grants	-	2,064	-	-	-
Capital reserves	750	1,339	635	500	-
Revenue	2,630	2,292	643	1,958	2,133
Net financing need for the year	-	-	-	-	-

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

The second prudential indicator is the Commissioner'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 Commissioner'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 includes any other long term liabilities (e.g. PFI schemes, finance leases). Whilst these increase the CFR, and therefore the Commissioner's borrowing requirement, these types of scheme include a borrowing facility and so the Commissioner is not required to separately borrow for these schemes. The Commissioner currently has £30k of such schemes within the CFR.

The Commissioner is asked to approve the CFR projections below:

£'000	2013/14 Actual	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate
Capital Financing Requirement					
Total CFR	25,275	24,382	23,574	22,763	21,983
Movement in CFR	-908	-893	-808	-811	-780

Movement in CFR represented by					
Net financing need for the year (above)	-	-	-	-	-
Less MRP/VRP and other financing movements	-908	-893	-808	-811	-780
Movement in CFR	-908	-893	-808	-811	-780

2.3 Minimum revenue provision (MRP) policy statement

The Commissioner is required to pay off an element of the accumulated General 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 full Commissioner to approve an **MRP Statement** in advance of each year. A variety of options are provided to Commissioners, so long as there is a prudent provision. The Commissioner 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); these options provide 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);

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 £'000	2013/14 Actual	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate
Fund balances / reserves	25,934	29,280	28,250	25,221	23,221
Capital receipts	554	710	562	718	718
Provisions	792	792	792	792	792
Total core funds	27,280	30,782	29,604	26,731	24,731
Working capital*	-445	-	-	-	-
Under/over borrowing**	-14,673	-14,191	-13,809	-13,447	-13,137
Expected investments	12,162	16,591	15,795	13,284	11,594

*Working capital balances shown are estimated year end; these may be higher mid-year

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 Commissioner's overall finances. The Commissioner 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.

%	2013/14 Actual	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate
Ratio	1.0%	1.0%	0.9%	0.9%	0.9%

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

2.7 Incremental impact of capital investment decisions on Commissioner tax

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

Incremental impact of capital investment decisions on the band D Commissioner Tax

£	2013/14 Actual	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate
Commissioner tax - band D	-0.83	0.11	-0.47	0.03	-0.11

3 BORROWING

The capital expenditure plans set out in Section 2 provide details of the service activity of the Commissioner. The treasury management function ensures that the Commissioner'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 Commissioner's treasury portfolio position at 31 March 2014, 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.

£'000	2013/14 Actual	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate
External Debt					
Debt at 1 April	11,159	10,602	10,191	9,765	9,316
Expected change in Debt	-557	-411	-427	-449	-470
Other long-term liabilities (OLTL)	-	-	-	-	-
Expected change in OLTL	-	-	-	-	-
Actual gross debt at 31 March	10,602	10,191	9,765	9,316	8,846
The Capital Financing Requirement	25,275	24,382	23,574	22,763	21,983
Under / (over) borrowing	14,673	14,191	13,809	13,447	13,137

Within the prudential indicators there are a number of key indicators to ensure the Commissioner operates its activities within well-defined limits. One of these is that the Commissioner needs to ensure 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 2015/16 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 Director of Finance reports that the Commissioner 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 £'000	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate
Debt	12,252	11,841	11,415	10,966
Other long term liabilities	-	-	-	
Total	12,252	11,841	11,415	10,966

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 full Commissioner. 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 Commissioners' plans, or those of a specific Commissioner, although this power has not yet been exercised.
2. The Commissioner is asked to approve the following authorised limit:

Authorised limit £'000	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate
Debt	15,252	14,841	14,415	13,966
Other long term liabilities	-	-	-	
Total	15,252	14,841	14,415	13,966

3.3 Prospects for interest rates

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

Annual Average %	Bank Rate %	PWLB Borrowing Rates % (including certainty rate adjustment)		
		5 year	25 year	50 year
Mar 2015	0.50	2.20	3.30	3.40
Jun 2015	0.50	2.20	3.50	3.50
Sep 2015	0.50	2.30	3.60	3.60
Dec 2015	0.50	2.40	3.70	3.70
Mar 2016	0.50	2.50	3.80	43.80
Jun 2016	0.75	2.60	4.00	4.00
Sep 2016	1.00	2.80	4.10	4.10
Dec 2016	1.00	2.90	4.20	4.20
Mar 2017	1.25	3.00	4.30	4.30
Jun 2017	1.25	3.10	4.40	4.40
Sep 2017	1.50	3.20	4.40	4.40
Dec 2017	1.50	3.30	4.50	4.50
Mar 2018	7.75	3.40	4.60	4.60

UK GDP growth surged during 2013 and 2014 but cooled somewhat towards the end of 2014. However, growth is expected to regain stronger momentum during 2015 and 2016 under the stimulative effect of the sharp fall in oil prices and inflation falling into negative territory and being near to zero until towards the end of 2015. This, combined with a significant rise in average wage rates, is expected to lead to consumer disposable income rising by around 3.5% in 2015. This would therefore strengthen consumer expenditure without much downside to the savings ratio. However, there still needs to be a significant rebalancing of the economy away from consumer spending to manufacturing, business investment and exporting in order for this recovery to become more firmly established. The falling level of unemployment and the reduction of spare capacity or slack in the economy, is expected to feed through into an increase in pressure for wage increases. This together with the sharp fall in the price of oil starting to fall out of the twelve month calculation of CPI inflation in quarter 4 of 2015, is expected to result in a sharp rise in inflation from near zero in that quarter and also onward into 2016.

The US, the biggest world economy, has generated stunning growth rates of 4.6% (annualised) in Q2 2014 and 5.0% in Q3, followed by a cooler 2.6% in Q4 (overall 2.4% for 2014 as a whole). This is hugely promising for the outlook for strong growth going forwards and it very much looks as if the US is now firmly on the path to full recovery from the financial crisis of 2008. Consequently, it is now confidently expected that the US will be the first major western economy to start on central rate increases by the end of 2015.

The current economic outlook and structure of market interest rates and government debt yields have several key treasury management implications:

- Greece: the general election on 25 January 2015 brought to power a coalition which is strongly anti EU imposed austerity. However, if this should eventually result in Greece leaving the Euro, it is unlikely that this will directly destabilise the Eurozone as the EU has put in place adequate firewalls to contain the immediate fallout to just Greece. However, the indirect effects of the likely strengthening of anti EU and anti austerity political parties throughout the EU is much more difficult to gauge;
 - As for the Eurozone in general, concerns in respect of a major crisis subsided considerably in 2013. However, the downturn in growth and inflation during the second half of 2014, and worries over the Ukraine situation and the Middle East, have led to a resurgence of those concerns as risks increase that it could be heading into a prolonged period of deflation and very weak growth. Sovereign debt difficulties have not gone away and major concerns could return in respect of individual countries that do not dynamically address fundamental issues of low growth, international uncompetitiveness and the need for overdue reforms of the economy (as Ireland has done). It is, therefore, possible over the next few years that levels of government debt to GDP ratios could continue to rise to levels that could result in a loss of investor confidence in the financial viability of such countries. Counterparty risks therefore remain elevated. This continues to suggest the use of higher quality counterparties for shorter time periods;
 - Investment returns are likely to remain relatively low during 2015/16 and beyond;
 - Borrowing interest rates have been highly volatile during 2014 and early 2015 as alternating bouts of good and bad news have promoted optimism, and then pessimism, in financial markets. The opening weeks of 2015 saw gilt yields dip to historically phenomenally low levels after inflation plunged, a flight to quality as a result of the Greek situation and the start of a huge programme of quantitative easing, (purchase of EZ government debt), by the ECB in January 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.
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3.4 Borrowing strategy

The Commissioner 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 Council'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 2015/16 treasury operations. The Director of Finance will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances:

- *if it was felt that there was a significant risk of a sharp FALL in long and short term rates (e.g. due to a marked increase of risks around relapse into recession or of risks of deflation), then long term borrowings will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered.*
- *if it was felt that there was a significant risk of a much sharper RISE in long and short term rates than that currently forecast, perhaps arising from a greater than expected increase in the anticipated rate to US tapering of asset purchases, or 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 appropriate decision making body 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 Commissioner's exposure to large fixed rate sums falling due for refinancing, and are required for upper and lower limits.

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

£'000	2015/16	2016/17	2017/18
Interest rate exposures			
	Upper	Upper	Upper
Limits on fixed interest rates based on net debt	11,841	11,415	10,966
Maturity structure of fixed interest rate borrowing 2015/16			
	Lower	Upper	
Under 12 months	0%	100%	
12 months to 2 years	0%	100%	
2 years to 5 years	0%	100%	
5 years to 10 years	0%	100%	
10 years and above	0%	100%	

3.5 Policy on borrowing in advance of need

As the Commissioner is not planning to borrow to finance the Capital Programme over the next 4 years there is no expectation of borrowing in advance of need.

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 options for rescheduling will be discussed with the Commissioner or Deputy Commissioner prior to any decision being taken.

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. More recently, in response to the evolving regulatory regime, the agencies have indicated they may remove these "uplifts". This process may commence during 2014/15 and / or 2015/16. The actual timing of the changes is still subject to discussion, but this does mean immediate changes to the credit methodology are required.

It is important to stress that the rating agency changes do not reflect any changes in the underlying status of the institution or credit environment, merely the implied level of sovereign support that has been built into ratings through the financial crisis. The eventual removal of implied sovereign support will only take place when the regulatory and economic environments have ensured that financial institutions are much stronger and less prone to failure in a financial crisis.

Both Fitch and Moody's provide "standalone" credit ratings for financial institutions. For Fitch, it is the Viability Rating, while Moody's has the Financial Strength Rating. Due to the future removal of sovereign support from institution assessments, both agencies have suggested going forward that these will be in line with their respective Long Term ratings. As such, there is no point monitoring both Long Term and these "standalone" ratings.

Furthermore, Fitch has already begun assessing its Support ratings, with a clear expectation that these will be lowered to 5, which is defined as "A bank for which there is a possibility of external support, but it cannot be relied upon." With all institutions likely to drop to these levels, there is little to no differentiation to be had by assessing Support ratings.

As a result of these rating agency changes, the credit element of our future methodology will focus solely on the Short and Long Term ratings of an institution. Rating Watch and Outlook information will continue to be assessed where it relates to these categories. This is the same process for Standard & Poor's that we have always taken, but a change to the use of Fitch and Moody's ratings. Furthermore, we will continue to utilise CDS prices as an overlay to ratings in our new methodology.

4.1 Investment policy

The Commissioner'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 Commissioner'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 Commissioner 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.

Continuing regulatory changes in the banking sector are designed to see greater stability, lower risk and the removal of expectations of Government financial support should an institution fail. This withdrawal of implied sovereign support is anticipated to have an effect on ratings applied to institutions. This will result in the key ratings used to monitor counterparties being the Short Term and Long Term ratings only. Viability, Financial Strength and Support Ratings previously applied will effectively become redundant. This change does not reflect deterioration in the credit environment but rather a change of method in response to regulatory changes.

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

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 5.2 under the ‘specified’ and ‘non-specified’ investments categories. Counterparty limits will be as set through the Commissioner’s treasury management practices – schedules.

4.2 Creditworthiness policy

The primary principle governing the Commissioner’s investment criteria is the security of its investments, although the yield or return on the investment is also a key consideration. After this main principle, the Commissioner will ensure that:

- It maintains a policy covering both the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security, and monitoring their security. This is set out in the specified and non-specified investment sections below; and
- It has sufficient liquidity in its investments. For this purpose it will set out procedures for determining the maximum periods for which funds may prudently be committed. These procedures also apply to the Commissioner’s prudential indicators covering the maximum principal sums invested.

The CFO constabulary will maintain a counterparty list in compliance with the following criteria and will revise the criteria and submit them to Commissioner for approval as necessary. These criteria are separate to that which determines which types of investment instrument are either specified or non-specified as it provides an overall pool of counterparties considered high quality which the Commissioner may use, rather than defining what types of investment instruments are to be used.

Credit rating information is supplied by Capita Asset Services, our treasury consultants, on all active counterparties that comply with the criteria below. Any counterparty failing to meet the criteria would be omitted from the counterparty (dealing) list. Any rating changes, rating watches (notification of a likely change), rating outlooks (notification of a possible longer term change) are provided to officers almost immediately after they occur and this information is considered before dealing. For instance, a negative rating watch applying to a counterparty at the minimum Crime Commissioners' criteria will be suspended from use, with all others being reviewed in light of market conditions

The criteria for providing a pool of high quality investment counterparties (both specified and non-specified investments) is:

- Banks 1 - good credit quality – the Commissioner will only use banks which:
 - i. are UK banks; and/or
 - ii. are non-UK and domiciled in a country which has a minimum sovereign Long Term rating of AAA
 and have, as a minimum, the following Fitch, Moody's and Standard and Poors credit ratings:
 - i. Long Term - *A-*
 - ii. Short Term - *F1*

Please note that only short-term ratings are relevant as the Commissioner only has call accounts with its bank based counterparties.

(N.B. Viability, Financial Strength and Support ratings have been removed and will not be considered in choosing counterparties.)

- Banks 2 – Part nationalised UK banks – Lloyds Banking Group and Royal Bank of Scotland. These banks can be included if they continue to be part nationalised or they meet the ratings in Banks 1 above.
- Banks 3 – The Commissioner's own banker for transactional purposes if the bank falls below the above criteria, although in this case balances will be minimised in both monetary size and time.
- Money market funds, including non-government funds– AAA
- UK Government (including gilts and the DMADF)
- Local authorities, Parish Councils, Commissioners etc.

A limit of 0% will be applied to the use of non-specified investments.

Country and sector considerations - Due care will be taken to consider the country, group and sector exposure of the Commissioner's investments. In part, the country selection will be chosen by the credit rating of the sovereign state in Banks 1 above. In addition:

- no more than 10% will be placed with any non-UK country at any time; (this applies to Banks 1 only not Money Market funds).
- limits in place above will apply to a group of companies;
- sector limits will be monitored regularly for appropriateness.

Use of additional information other than credit ratings. Additional requirements under the Code require the Commissioner to supplement credit rating information. Whilst the above criteria relies primarily on the application of credit ratings to provide a pool of appropriate counterparties for officers to use, additional operational market information will be applied before making any specific investment decision from the agreed pool of counterparties. This additional market information (for example Credit Default Swaps, negative rating watches/outlooks) will be applied to compare the relative security of differing investment counterparties.

Time and monetary limits applying to investments. The time and monetary limits for institutions on the Commissioner's counterparty list are as follows

	Fitch Long term Rating (or equivalent)	Money Limit	Time Limit
Limit 1 Category Banks	A- F1 (Short term)	25% of available funds up to £5m per institution	364 days
Limit 2 Category Banks – part nationalised	A- F1 (Short term)	25% of available funds up to £5m per institution	364 days
Limit 3 Category Commissioner's banker (not meeting Banks Limit 1)		£5m	Overnight
Limit 4 Category DMADF	AAA	100% available funds	6 months
Limit 5 Category Local Authorities	N/A	£5m	364 days
	Fund Rating	Money and/or % limit	Time Limit
Limit 6 Category Money Market Funds – including non-government funds	AAA	100% of available funds. If over £5m, spread over 2 funds.	liquid

3. The proposed criteria for specified and non-specified investments are shown in Appendix 5.4 for approval.

4.3 Country limits

The Commissioner has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of **AAA** from Fitch (*or equivalent*). This list will be added to, or deducted from, by officers should ratings change in accordance with this policy.

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:

- 2015/16 0.75%
- 2016/17 1.25%
- 2017/18 2.00%

There are downside risks to these forecasts (i.e. start of increases in Bank Rate occurs later) if economic growth weakens. However, should the pace of growth quicken, there could be an upside risk.

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

2015/16	0.50%
2016/17	0.90%
2017/18	1.50%
2018/19	2.00%
2019/20	2.75%
2020/21	3.00%
2021/22	3.25%
2022/23	3.25%
Later years	3.50%

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

The Commissioner is asked to approve the treasury indicator and limit: -

Maximum principal sums invested > 364 days			
£m	2015/16	2016/17	2017/18
Principal sums invested > 364 days	£0m	£0m	£0m

For its cash flow generated balances, the Commissioner will seek to utilise its business reserve instant access and notice accounts, money market funds and short-dated deposits (overnight to 364 days) in order to benefit from the compounding of interest.

4.5 Investment risk benchmarking

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

Security - The Council's maximum security risk benchmark for the current portfolio, when compared to these historic default tables, is:

- **0.017% historic risk of default when compared to the whole portfolio.**

Liquidity – in respect of this area the Commissioner seeks to maintain:

- Bank overdraft - £100K overnight for unforeseen expenditure
- Liquid short term deposits of at least 75% available with a week's notice.

Yield - local measures of yield benchmarks are

- Investments – internal returns above the overnight LIBOR rate -0.25%

4.6 End of year investment report

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

5 APPENDICES

1. Economic background
 2. Treasury management practice 1 – credit and counterparty risk management (option 2)
 3. Treasury management scheme of delegation
 4. The treasury management role of the section 151 officer
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5.1 APPENDIX: Economic Background

UK. After strong UK GDP growth in 2013 at an annual rate of 2.7%, and then growth in 2014 of 0.6% in Q1, 0.8% Q2, 0.7% Q3 and 0.5% Q4 (annual rate for 2014 of 2.6%), growth is expected to gain increased momentum during 2015 and 2016 to annual rates of 2.9%, (2017 2.7%). This will be a response to two developments; firstly, the stimulative effect of the sharp fall in oil prices in quarter 4 of 2014 and then inflation potentially falling into negative territory during 2015, but anyway being near to zero until towards the end of the year. Secondly, due to an expected return to a significant rise in average wage rates due to the continuing fall in unemployment to about 5.5% by mid 2015, (the long run equilibrium level is 5.0%), and the further erosion of spare capacity, (slack), to about 0.5% of GDP. This is expected to lead to total consumer disposable income rising by no less than around 3.5% during quarter 3 2015. This would therefore strengthen consumer expenditure, but without much downside to the savings ratio.

However, for this recovery to become more balanced and sustainable in the longer term, the recovery still needs to move away from dependence on consumer expenditure and the housing market to exporting, and particularly of manufactured goods, both of which need to substantially improve on their recent lacklustre performance. In addition, there has been a need for a major improvement in labour productivity, which has languished at dismal levels since 2008, to support longer term increases in pay rates and economic growth after the positive effect of the fall in oil prices dissipates. The February Inflation Report contained good news on that score that productivity was forecast to increase by just under 0.75% in the first three quarters of 2015.

The February Inflation Report also explained that the initial fall in the price of oil of over 50% would cause an overall reduction in CPI of about 0.8% in quarter 2 2015 and boost UK GDP by around 0.5% during the MPC's three year forecast period. It also forecast that the sharp fall in the price of oil and its knock on effects, would start falling out of the twelve month calculation of CPI inflation in quarter 4 of 2015. This is expected to result in a sharp rise in inflation from near zero in that quarter and also onward into 2016. The report also mentioned a potential risk of deflation becoming embedded, which could then require remedial action by the MPC such as a cut in Bank Rate and / or further quantitative easing, This is viewed as being a small risk given the above expected sharp increase in inflationary pressures. However, while inflation is at or near 0% for much of 2015, it is unlikely that the MPC would make a start on increasing Bank Rate. Market expectations for the first increase in Bank Rate have therefore moved from quarter 3 2015 after the November 2014 report, to around mid year 2016 during February 2015. However, the MPC is focused on where inflation will be over a 2 – 3 year time horizon so too much emphasis should not be placed on the short term inflation outlook, especially when the February report identified a slight increase in inflationary pressures on that time horizon to just above the 2% target. This treasury management report is therefore based on a forecast of a first increase in Bank Rate in quarter 1 of 2016, though it would be quite possible for it to be in quarter 4 of 2015 if events were to turn out favourably in Greece, the EZ as a whole and elsewhere.

The return to strong growth has helped lower forecasts for the increase in Government debt over the last year but monthly public sector deficit figures during 2014 have disappointed, being only a fraction lower than the previous year through to December 2014. The autumn statement, therefore, had to revise the speed with which the deficit is forecast to be eliminated. The flight to quality in January 2015 has seen gilt yields fall to incredibly low levels, which will reduce interest costs on new and replacement government debt.

Eurozone (EZ). The Eurozone is facing an increasing threat from weak or negative growth and from deflation. In January 2015, the inflation rate fell further, to reach a low of -0.6%. However, this is an average for all EZ countries and includes some countries with even higher negative rates of inflation. Initially, the ECB took some rather limited action in June and September 2014 to loosen monetary policy in order to promote growth. As this failed to have much of a discernible effect, the ECB launched a massive €1.1 trillion programme of quantitative easing in January 2015 to buy up high credit quality government debt of selected EZ countries. This programme will run to September 2016.

Concern in financial markets for the Eurozone had subsided considerably after the prolonged crisis during 2011-2013. However, sovereign debt difficulties have not gone away and major issues could return in respect of any countries that do not dynamically address issues of low growth, international uncompetitiveness and the need for overdue reforms of the economy, (as Ireland has done). It is, therefore, possible over the next few years that levels of government debt to GDP ratios could continue to rise for some countries. This could mean that sovereign debt concerns have not disappeared but, rather, have only been postponed. The ECB's pledge in 2012 to buy unlimited amounts of bonds of countries which ask for a bailout has provided heavily indebted countries with a strong defence against market forces. This has bought them time to make progress with their economies to return to growth or to reduce the degree of recession. However, debt to GDP ratios (2013 figures) of Greece 180%, Italy 133%, Portugal 129%, Ireland 124% and Cyprus 112%, remain a cause for concern, especially as some of these countries are experiencing continuing rates of increase in debt in excess of their rate of economic growth i.e. these debt ratios are likely to continue to deteriorate. Any sharp downturn in economic growth would make these countries particularly vulnerable to a new bout of sovereign debt crisis. It should also be noted that Italy has the third biggest debt mountain in the world behind Japan and the US.

Greece: the general election on 25 January 2015 has brought to power a coalition which is anti EU imposed austerity. Although it is not certain that Greece will leave the Euro, the recent intractability of the troika (the EU, ECB and IMF), to finding a negotiated compromise with the new Greek government leaves this as a real possibility. However, if Greece was to leave the EZ, it is unlikely that this will directly destabilise the Eurozone as the EU has put in place adequate firewalls to contain the immediate fallout to just Greece. Nevertheless, the indirect effects of the likely strengthening of anti EU and anti-austerity political parties throughout the EU is much more difficult to gauge. There are particular concerns as to whether democratically elected governments will lose the support of electorates suffering under EZ imposed austerity programmes, especially in countries which have high unemployment rates. Of particular concern is the fact that Spain and Portugal have general elections coming up in late 2015. This will give ample opportunity for anti-austerity parties to make a big impact.

There are also major concerns as to whether the governments of France and Italy will effectively implement austerity programmes and undertake overdue reforms to improve national competitiveness. These countries already have political parties with major electoral support for anti EU and anti-austerity policies. Any loss of market confidence in either of the two largest Eurozone economies, after Germany, would present a huge challenge to the resources of the ECB to defend their debt.

USA. The U.S. Federal Reserve ended its monthly asset purchases in October 2014. GDP growth rates (annualised) for Q2 of 4.6%, Q3 of 5.0% and Q4 of 2.6%, (overall 2.4% during 2014 as a whole), provides great promise for strong growth going forward. It is confidently forecast that the first increase in the Fed. rate will occur by the end of 2015.

China. Government action in 2014 to stimulate the economy almost succeeded in achieving the target of 7.5% growth but recent government statements have emphasised

that growth going forward will slow marginally as this becomes the new normal for China. There are concerns that the Chinese leadership has only just started to address an unbalanced economy, which is heavily over dependent on new investment expenditure, and for a potential bubble in the property sector to burst, as it did in Japan in the 1990s, with its consequent impact on the financial health of the banking sector. There are also concerns around the potential size, and dubious creditworthiness, of some bank lending to local government organisations and major corporates. This primarily occurred during the government promoted expansion of credit, which was aimed at protecting the overall rate of growth in the economy after the Lehman's crisis.

Japan. Japan is causing considerable concern as the increase in sales tax in April 2014 has suppressed consumer expenditure and growth to the extent that it has slipped back into recession. The Japanese government already has the highest debt to GDP ratio in the world.

CAPITA ASSET SERVICES FORWARD VIEW

Economic forecasting remains difficult with so many external influences weighing on the UK. Our Bank Rate forecasts, (and also MPC decisions), will be liable to further amendment depending on how economic data transpires over 2015. 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, due to the high volume of gilt issuance in the UK, and of bond issuance in other major western countries. Increasing investor confidence in eventual world economic recovery is also likely to compound this effect as recovery will encourage investors to switch from bonds to equities.

There has been exceptionally high volatility in gilt yields and PWLB rates during January and February 2015. It is likely that this trend could continue through 2015 and that there could be swings of 50 basis points, (0.50%), during even one quarter.

The overall balance of risks to economic recovery in the UK is currently evenly balanced. Only time will tell just how long this current period of strong economic growth will last; it also remains exposed to vulnerabilities in a number of key areas.

The interest rate forecasts in this report are based on an initial assumption that there will not be a major resurgence of the EZ debt crisis. There is an increased risk that Greece could end up leaving the Euro but if this happens, the EZ now has sufficient fire walls in place that a Greek exit would have little immediate direct impact on the rest of the EZ and the Euro. It is therefore expected that there will be an overall managed, albeit painful and tortuous, resolution of any EZ debt crisis that may occur where EZ institutions and governments eventually do what is necessary - but only when all else has been tried and failed. Under this assumed scenario, growth within the EZ will be weak at best for the next couple of years with some EZ countries experiencing low or negative growth, which will, over that time period, see an increase in total government debt to GDP ratios. There is a significant danger that these ratios could rise to the point where markets lose confidence in the financial viability of one, or more, countries, especially if growth disappoints and / or efforts to reduce government deficits fail to deliver the necessary reductions. However, it is impossible to forecast whether any individual country will lose such confidence, or when, and so precipitate a sharp resurgence of the EZ debt crisis. While the ECB has adequate resources to manage a debt crisis in a small EZ country, if one, or more, of the larger

countries were to experience a major crisis of market confidence, this would present a serious challenge to the ECB and to EZ politicians.

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

- Geopolitical risks in Eastern Europe, the Middle East and Asia, increasing safe haven flows.
- UK strong economic growth is weaker than we currently anticipate.
- Weak growth or recession in the UK's main trading partners - the EU, US and China.
- A resurgence of the Eurozone sovereign debt crisis.
- Recapitalisation of European banks requiring more government financial support.
- Monetary policy action failing to stimulate sustainable growth and to combat the threat of deflation in western economies, especially the Eurozone and Japan.

The potential for upside risks to current forecasts for UK gilt yields and PWLB rates, especially for longer term PWLB rates include: -

- An adverse reaction by financial markets to the result of the UK general election in May 2015 and the EU, economic and debt management policies adopted by the new government.
- The ECB severely disappointing financial markets with a programme of asset purchases which proves insufficient to significantly stimulate growth in the EZ.
- The commencement by the US Federal Reserve of increases in the Fed. funds rate in 2015, 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. There could also be a sharp fundamental reassessment of investments in the debt and equities of emerging countries which have chased higher yields during a prolonged period when yields and returns in western countries have been heavily suppressed; countries such as Brazil and Russia are already in recession and facing major economic and political challenges.
- UK inflation returning to significantly higher levels than in the wider EU and US, causing an increase in the inflation premium inherent to gilt yields.

5.2 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 maximum of 0% will be held in aggregate in non-specified investment

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:

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

Specified

	Minimum credit criteria	** Max % of total investments/ £ limit per institution	Max. maturity period
DMADF – UK Government	UK sovereign rating	100%	6 months
UK Government gilts	UK sovereign rating	25%	364 Days
UK Government Treasury bills	UK sovereign rating	25%	364 Days
UK Government gilts	AAA	25%	6 months
Money market funds	AAA	100%	Liquid
Local authorities	N/A	100%	364 Days

Non Specified – Not used

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

The CLG issued Investment Guidance in 2010, and this forms the structure of the Commissioner's policy below. These guidelines do not apply to either trust funds or pension funds which operate under a different regulatory regime.

The key intention of the Guidance is to maintain the current requirement for Commissioners to invest prudently, and that priority is given to security and liquidity before yield. In order to facilitate this objective the guidance requires this Commissioner to have regard to the CIPFA publication Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes. The former Police Authority adopted the Code in Feb 2006 and the Commissioner will apply its principles to all investment activity. In accordance with the Code, the CFO (to PCC) has produced its treasury management practices (TMPs). This part, TMP 1(1), covering investment counterparty policy requires approval each year.

Annual investment strategy - The key requirements of both the Code and the investment guidance are to set an annual investment strategy, as part of its annual treasury strategy for the following year, covering the identification and approval of following:

- The strategy guidelines for choosing and placing investments, particularly non-specified investments.
- The principles to be used to determine the maximum periods for which funds can be committed.
- Specified investments that the Commissioner will use. These are high security (i.e. high credit rating, although this is defined by the Commissioner, and no guidelines are given), and high liquidity investments in sterling and with a maturity of no more than a year.

The investment policy proposed for the Commissioner is:

Strategy guidelines – The main strategy guidelines are contained in the body of the treasury strategy statement.

Specified investments – These investments are sterling investments of not more than one-year maturity, or those which could be for a longer period but where the Commissioner has the right to be repaid within 12 months if it wishes. These are considered low risk assets where the possibility of loss of principal or investment income is small. These would include sterling investments which would not be defined as capital expenditure with:

1. The UK Government (such as the Debt Management Account deposit facility, UK treasury bills or a gilt with less than one year to maturity).
2. Supranational bonds of less than one year's duration.
3. A local authority.
4. Pooled investment vehicles (such as money market funds) that have been awarded a high credit rating by a credit rating agency. For category 4 this covers pooled investment vehicles, such as money market funds, rated AAA by Standard and Poor's, Moody's and / or Fitch rating agencies.
5. A body that is considered of a high credit quality. For category 5 this covers bodies with a minimum Short Term rating of F1 (or the equivalent) as rated by Standard and Poor's, Moody's and / or Fitch rating agencies.

Within these bodies, and in accordance with the Code, the Commissioner has set additional criteria to set the time and amount of monies which will be invested in these bodies. The criteria is set out below:

	Fitch Long term Rating (or equivalent)	Money Limit	Time Limit
Limit 1 Category Banks	A- F1 (Short term)	25% of available funds up to £5m per institution	364 days
Limit 2 Category Banks – part nationalised	A- F1 (Short term)	25% of available funds up to £5m per institution	364 days
Limit 3 Category Commissioner’s banker (not meeting Banks Limit 1)		£5m	Overnight
Limit 4 Category DMADF	AAA	100% available funds	6 months
Limit 5 Category Local Authorities	N/A	£5m	364 days
	Fund Rating	Money and/or % limit	Time Limit
Limit 6 Category Money Market Funds – including non-government funds	AAA	100% of available funds. If over £5m, spread over 2 funds.	Liquid

Non Specified Investments – not used

The monitoring of investment counterparties - The credit rating of counterparties will be monitored regularly. The Commissioner receives credit rating information (changes, rating watches and rating outlooks) from Capita Asset Services as and when ratings change, and counterparties are checked. On occasion ratings may be downgraded when an investment has already been made. The criteria used are such that a minor downgrading should not affect the full receipt of the principal and interest. Any counterparty failing to meet the criteria will be removed from the list immediately by the CFO (constabulary), and if required new counterparties which meet the criteria will be added to the list.

5.3 APPENDIX: Treasury management scheme of delegation

- (i) Finance Sub Group (FSG) /Commissioner (Business Co-Ordination Board) BCB
- receiving and reviewing reports on treasury management policies, practices and activities;
 - approval of annual strategy.
- (ii) Commissioner/BCB
- 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;
 - approving the selection of external service providers and agreeing terms of appointment.
- (iii) FSG/Commissioner
- reviewing the treasury management policy and procedures and making recommendations to the responsible body.

5.4 APPENDIX: The treasury management role of the section 151 officer

The S151 officer (CFO to PCC)

- 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.

