

**Treasury Management Strategy**

**Statement**

Minimum Revenue Provision Policy Statement and Annual Investment Strategy

Cambridgeshire Police And Crime Commissioner

2019/20

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# INTRODUCTION

* 1. Background

The Police and Crime Commissioner (“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 the capital spending obligations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses. On occasion any debt previously drawn may be restructured to meet the Commissioner’s risk or cost objectives.

The contribution the treasury management function makes to the authority is critical, as the balance of debt and investment operations ensure liquidity or the ability to meet spending commitments as they fall due, either on day-to-day revenue or for larger capital projects. The treasury operations will see a balance of the interest costs of debt and the investment income arising from cash deposits affecting the available budget. Since cash balances generally result from reserves and balances, it is paramount to ensure adequate security of the sums invested, as a loss of principal will in effect result in a loss to the General Fund Balance.

CIPFA defines treasury management as:

*“The management of the local authority’s borrowing, 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.”*

Revised reporting is required for the 2019/20 reporting cycle due to revisions of the MHCLG Investment Guidance, the MHCLG Minimum Revenue Provision (MRP) Guidance, the CIPFA Prudential Code and the CIPFA Treasury Management Code. The primary reporting changes include the introduction of a capital strategy, to provide a longer-term focus to the capital plans, and greater reporting requirements surrounding any commercial activity undertaken under the Localism Act 2011. The capital strategy is being reported separately.

This authority has not engaged in any commercial investments and has no non-treasury investments.

* 1. Reporting requirements
     1. Capital Strategy

The CIPFA revised 2017 Prudential and Treasury Management Codes require, for 2019-20, all local authorities to prepare an additional report, a capital strategy report, which will provide the following:

* a high-level long term overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services
* an overview of how the associated risk is managed
* the implications for future financial sustainability

The aim of this capital strategy is to ensure that all elected members on the full council fully understand the overall long-term policy objectives and resulting capital strategy requirements, governance procedures and risk appetite.

* + 1. Treasury Management reporting

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:

1. the capital plans (including prudential indicators);
2. a minimum revenue provision (MRP) policy (how residual capital expenditure is charged to revenue over time);
3. the treasury management strategy (how the investments and borrowings are to be organised) including treasury indicators; and
4. 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.

**An annual treasury report** – This provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

* + - 1. Scrutiny

The above reports are required to be adequately scrutinised before being recommended to the Commissioner. This role is undertaken by the Finance Sub Group.

* 1. Treasury Management Strategy for 2019/20

The strategy for 2019/20 covers two main areas:

**Capital issues**

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

**Treasury management issues**

1. the current treasury position;
2. treasury indicators which limit the treasury risk and activities of the Commissioner;
3. prospects for interest rates;
4. the borrowing strategy;
5. policy on borrowing in advance of need;
6. debt rescheduling;
7. the investment strategy;
8. creditworthiness policy; and
9. the 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. Training

The CIPFA Code requires the responsible officer to ensure that members with responsibility for treasury management receive adequate training in treasury management. This especially applies to members responsibe for scrutiny. The 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.

# THE CAPITAL PRUDENTIAL INDICATORS 2019/20 – 2021/22

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.

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

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Capital expenditure**  **£000’s** | **2017/18**  **Actual** | **2018/19**  **Estimate** | **2019/20**  **Estimate** | **2020/21**  **Estimate** | **2021/22**  **Estimate** |
| **Total** | 5,713 | 4,345 | 8,930 | 14,200 | 8,300 |
| **Financed by:** |  |  |  |  |  |
| Capital receipts | 18 | 2,034 | 1,888 | 100 | - |
| Capital grants | 874 | 720 | 506 | 506 | 506 |
| Capital reserves | 4,041 | 1,291 | 3,526 | 742 | - |
| Revenue | 881 | - | - | - | - |
| Borrowing in advance of need | - | 30 | 3,011 | 7,059 | - |
| **Net financing need for the year** | **-** | **-** | **-** | **5,657** | **7,794** |

* 1. 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 assets 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 £53k of such schemes within the CFR.

The Commissioner is asked to approve the CFR projections below:

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **£000’s** | **2017/18**  **Actual** | **2018/19**  **Estimate** | **2019/20**  **Estimate** | **2020/21**  **Estimate** | **2021/22**  **Estimate** |
| **Capital Financing Requirement** | | | | | |
| **Total CFR** | 21,947 | 21,203 | 20,489 | 25,460 | 32,292 |
| **Movement in CFR** | -875 | -744 | -714 | 5,106 | 6,832 |
|  |  |  |  |  |  |
| **Movement in CFR represented by** | | | | | |
| Net financing need for the year (above) | - | - | - | 5,657 | 7,794 |
| Less MRP/VRP and other financing movements | -875 | -744 | -714 | -686 | -962 |
| **Movement in CFR** | -875 | -774 | -714 | 5,106 | 6,832 |

* 1. 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’s** | **2017/18**  **Actual** | **2018/19**  **Estimate** | **2019/20**  **Estimate** | **2020/21**  **Estimate** | **2021/22**  **Estimate** |
| Fund balances/reserves | 23,032 | 19,193 | 14,879 | 15,557 | 13,689 |
| Capital receipts | 1,913 | 1,924 | 100 | - | - |
| Provisions | 1,022 | 792 | 792 | 792 | 792 |
| **Total core funds** | **25,967** | **21,909** | **15,771** | **16,349** | **14,481** |
| Working capital | -8,039 | - | - | - | - |
| Under/over borrowing | -2,854 | -2,812 | -2,619 | -2,478 | -2,085 |
| **Expected investments** | **15,075** | **19,097** | **13,152** | **13,871** | **12,396** |

* 1. 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).

MHCLG regulations have been issued which require the Commissioner to approve **an MRP Statement** in advance of each year. A variety of options are provided to councils, 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 MHCLG regulations. This option provides for an approximate 4% reduction in the borrowing need (CFR) each year.

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

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

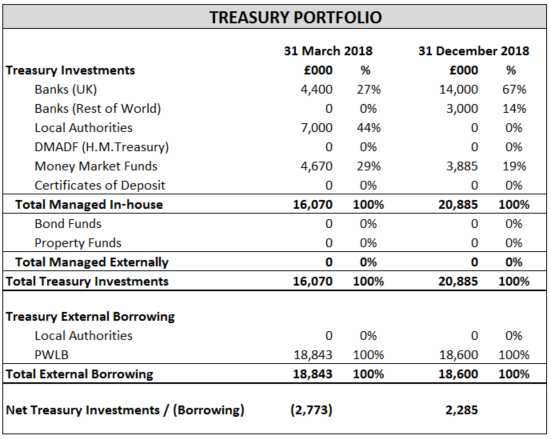
Repayments included in annual PFI or finance leases are applied as MRP.

# 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 the relevant professional codes, so that sufficient cash is available to meet this service activity and the Commissioners capital strategy. 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.

* 1. Current portfolio position

The overall treasury management portfolio as at 31 March 2018 and for the position as at 31 December 2018 are shown below for both borrowing and investments.



The Commissioner’s forward projections for borrowing are summarised below. The table shows the actual external debt, against the underlying capital borrowing need, (the Capital Financing Requirement - CFR), highlighting any over or under borrowing.

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **£000’s** | **2017/18**  **Actual** | **2018/19**  **Estimate** | **2019/20**  **Estimate** | **2020/21**  **Estimate** | **2021/22**  **Estimate** |
| **External Debt** | | | | | |
| Debt at 1 April | 9,313 | 18,844 | 18,353 | 17,839 | 22,959 |
| Expected change in Debt | 9,530 | -491 | -513 | 5,120 | 7,232 |
| Other long-term liabilities (OLTL) | - | - | - | - | - |
| Expected change in OLTL | - | - | - | - | - |
| **Actual gross debt at 31 March** | **18,844** | **18,353** | **17,839** | **22,959** | **30,192** |
| **The Capital Financing Requirement** | **21,947** | **21,203** | **20,489** | **25,460** | **32,292** |
| **Under / (over) borrowing** | **2,854** | **9,884** | **15,821** | **15,561** | **15,561** |

Within the prudential indicators there are a number of key indicators to ensure that the Commissioner’s activities are operated within well-defined limits. One of these is that the Commissioner needs to ensure that the 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 2019/20 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.

* 1. 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’s** | **2018/19**  **Estimate** | **2019/20**  **Estimate** | **2020/21**  **Estimate** | **2021/22**  **Estimate** |
| Debt | 20,494 | 20,003 | 24,609 | 24,609 |
| Other long term liabilities | - | - | - | - |
| Total | 20,494 | 20,003 | 24,609 | 24,609 |

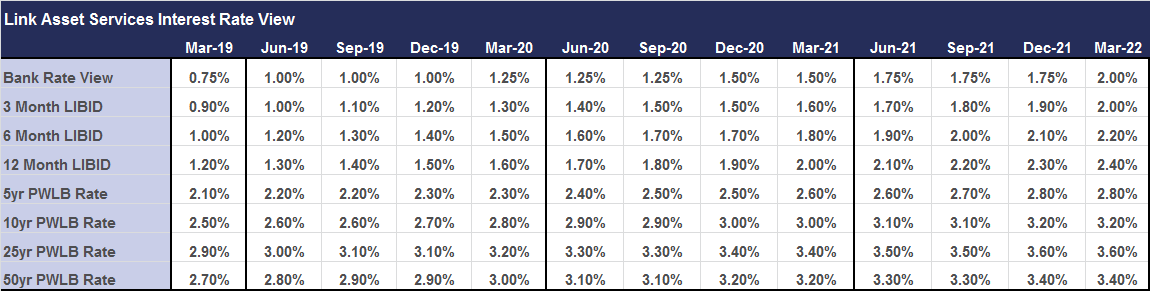
**The authorised limit for external debt.** This is a key prudential indicator and represents a control on the maximum level of borrowing. This represents a limit beyond which external debt is prohibited, and this limit needs to be set or revised by the Commissioner. It reflects the level of external 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 authorities and councils’ plans, or those of a specific authority or council, although this power has not yet been exercised.
2. The Commissioner is asked to approve the following authorised limit:

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Authorised limit £000’s** | **2018/19**  **Estimate** | **2019/20**  **Estimate** | **2020/21**  **Estimate** | **2021/22**  **Estimate** |
| Debt | 23,494 | 23,003 | 27,609 | 34,842 |
| Other long term liabilities | - | - | - | - |
| Total | 23,494 | 23,003 | 27,609 | 34,842 |

* 1. Prospects for interest rates

The Commissioner has appointed Link 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 their central view:



The flow of generally positive economic statistics after the quarter ended 30 June meant that it came as no surprise that the MPC came to a decision on 2 August to make the first increase in Bank Rate above 0.5% since the financial crash, from 0.5% to 0.75%. Growth became increasingly strong during 2018 until slowing significantly during the last quarter. At their November quarterly Inflation Report meeting, the MPC left Bank Rate unchanged, but expressed some concern at the Chancellor’s fiscal stimulus in his Budget, which could increase inflationary pressures. However, it is unlikely that the MPC would increase Bank Rate in February 2019, ahead of the deadline in March for Brexit. On a major assumption that Parliament and the EU agree a Brexit deal in the first quarter of 2019, then the next increase in Bank Rate is forecast to be in May 2019, followed by increases in February and November 2020, before ending up at 2.0% in February 2022.

The overall longer run future trend is for gilt yields, and consequently PWLB rates, to rise, albeit gently. However, over about the last 25 years, we have been through a period of falling bond yields as inflation subsided to, and then stabilised at, much lower levels than before, and supported by central banks implementing substantial quantitative easing purchases of government and other debt after the financial crash of 2008. Quantitative easing, conversely, also caused a rise in equity values as investors searched for higher returns and purchased riskier assets. In 2016, we saw the start of a reversal of this trend with a sharp rise in bond yields after the US Presidential election in November 2016, with yields then rising further as a result of the big increase in the US government deficit aimed at stimulating even stronger economic growth. That policy change also created concerns around a significant rise in inflationary pressures in an economy which was already running at remarkably low levels of unemployment. Unsurprisingly, the Fed has continued on its series of robust responses to combat its perception of rising inflationary pressures by repeatedly increasing the Fed rate to reach 2.25 – 2.50% in December 2018. It has also continued its policy of not fully reinvesting proceeds from bonds that it holds as a result of quantitative easing, when they mature. We have, therefore, seen US 10 year bond Treasury yields rise above 3.2% during October 2018 and also seen investors causing a sharp fall in equity prices as they sold out of holding riskier assets. However, by early January 2019, US 10 year bond yields had fallen back considerably on fears that the Fed was being too aggressive in raising interest rates and was going to cause a recession. Equity prices have been very volatile on alternating good and bad news during this period.

From time to time, gilt yields, and therefore PWLB rates, can be subject to exceptional levels of volatility due to geo-political, sovereign debt crisis, emerging market developments and sharp changes in investor sentiment. Such volatility could occur at any time during the forecast period.

Economic and interest rate forecasting remains difficult with so many external influences weighing on the UK. The above forecasts, (and MPC decisions), will be liable to further amendment depending on how economic data and developments in financial markets transpire over the next year. Geopolitical developments, especially in the EU, could also have a major impact. Forecasts for average investment earnings beyond the three-year time horizon will be heavily dependent on economic and political developments.

**Investment and borrowing rates**

* Investment returns are likely to remain low during 2019/20 but to be on a gently rising trend over the next few years.
* Borrowing interest rates have been volatile so far in 2018/19 and while they were on a rising trend during the first half of the year, they have back tracked since then until early January. 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 the future when authorities may not be able to avoid new borrowing to finance capital expenditure and/or the refinancing of maturing debt;
* There will remain a cost of carry (the difference between higher borrowing costs and lower investment returns), to any new long-term borrowing that causes a temporary increase in cash balances as this position will, most likely, incur a revenue cost.
  1. 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 Commissioner’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 2018/19 treasury operations. The Director of Finance will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances:

1. *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.
2. *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 appropriate decision making bodyat the next available opportunity.

* 1. Policy on borrowing in advance of need

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

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

* 1. 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:

1. the generation of cash savings and / or discounted cash flow savings;
2. helping to fulfil the treasury strategy;
3. 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 discussed with the Commissioner or Deputy Commissioner prior to any decision being taken.

# ANNUAL INVESTMENT STRATEGY

* 1. Investment policy

The Commissioner’s investment policy has regard to the CLG’s Guidance on Local Government Investments (“the Guidance”) and the CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes 2017 (“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. 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 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 5.4 under the ‘specified’ and ‘non-specified’ investments categories. Counterparty limits will be as set through the Commissioner’s treasury management practices – schedules.

* 1. 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 will maintain a counterparty list in compliance with the following criteria and will revise the criteria and submit them to the 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 Link 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 the longer term bias outside the central rating view) 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 of the Commissioner’s 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:
  + 1. are UK banks; and/or
    2. are non-UK and domiciled in a country which has a minimum sovereign Long Term rating of AA-

and have, as a minimum, the following Fitch, Moody’s and Standard and Poors credit ratings (where rated):

* + 1. Short Term – F1
    2. Long Term – A-
* Banks 2 – Part nationalised UK bank – Royal Bank of Scotland. This bank can be included provided it continues to be part nationalised or it meets 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 invested.
* Money market funds (MMFs) CNAV – AAA
* Money market funds (MMFs) LVNAV – AAA
* Money market funds (MMFs) VNAV – AAA
* Ultra-Short Dated Bond Funds with a credit rating of at least 1.25 – AAA
* Ultra-Short Dated Bond Funds with a credit rating of at least 1.50 - AAA
* UK Government (including gilts, Treasury Bills and the DMADF)
* Local authorities, parish councils, Commissioners etc

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

**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 (these will cover both specified and non-specified investments):

|  |  |  |  |
| --- | --- | --- | --- |
|  | **Fitch Long Term Rating** | **Money and/or % Limit** | **Time Limit** |
| Banks 1 - higher quality | A- / F1 (Short term) | 25% of available funds up to £10m per institution | 364 days |
| Banks 2 – part nationalised | A- / F1 (Short term) | 25% of available funds up to £10m per institution | 364 days |
| Limit 3 category – Commissioner’s banker (not meeting Banks 1) |  | £10m | Overnight |
| DMADF | AAA | unlimited | 6 months |
| Local authorities | N/A | £10m | 364 days |
|  | **Fund rating** | **Money and/or % Limit** | **Time Limit** |
| Money market funds CNAV | AAA | 100% of available funds | Liquid |
| Money market funds LVNAV | AAA | 100% of available funds | Liquid |
| Money market funds VNAV | AAA | 100% of available funds | Liquid |
| Ultra-Short Dated Bonds Funds | AAA | 100% of available funds | Liquid |

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

* 1. Country and sector limits

Due care will be taken to consider the country, group and sector exposure of the Commissioner’s investments.

The Commissioner has determined that approved counterparties from countries with a minimum sovereign credit rating of AA- from Fitch or equivalent will be used. This list will be added to, or deducted from, by officers should ratings change in accordance with this policy.

In addition:

* no more than 50% 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.
  1. Investment strategy

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

**Investment returns expectations.** Bank Rate is forecast to stay flat at 0.50% until quarter 4 2018 and not to rise above 1.25% by quarter 1 2021. Bank Rate forecasts for financial year ends (March) are:

2017/18 0.50%

2018/19 0.75%

2019/20 1.00%

2020/21 1.25%

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

2017/18 0.40%

2018/19 0.60%

2019/20 0.90%

2020/21 1.25%

2021/22 1.50%

2022/23 1.75%

2023/24 2.00%

Later years 2.75%

The overall balance of risks to these forecasts is currently skewed to the upside and are dependent on how strong GDP growth turns out, how quickly inflation pressures rise and how quickly the Brexit negotiations move forward positively.

**Investment treasury indicator and limit** - total principal funds invested for greater than 365 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 & 365 days** | | | |
| **£** | **2018/19** | **2019/20** | **2020/21** |
| Principal sums invested > 364 & 365 days | £0 | £0 | £0 |

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 365 days) in order to benefit from the compounding of interest.

* 1. 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 Commissioner’s maximum security risk benchmark for the current portfolio, when compared to these historic default tables, is:

* + 0.02% historic risk of default when compared to the whole portfolio.

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

* + Bank overdraft - £100k
  + Liquid short term deposits having the lower of at least £5m or 25% of funds available with a week’s notice.

Yield - local measures of yield benchmarks are:

* + Investments – internal returns above the overnight LIBOR rate -0.25%
  1. 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.

# APPENDICES

* 1. Prudential and treasury indicators and MRP statement
  2. Interest rate forecasts
  3. Economic background
  4. Treasury management practice – credit and counterparty risk management
  5. Treasury management scheme of delegation
  6. The treasury management role of the section 151 officer
  7. APPENDIX: The Capital Prudential And Treasury Indicators 2018/19 – 2020/21 And MRP Statement

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.

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

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Capital expenditure**  **£000’s** | **2017/18**  **Actual** | **2018/19**  **Estimate** | **2019/20**  **Estimate** | **2020/21**  **Estimate** | **2021/22**  **Estimate** |
| **Total** | 5,713 | 4,345 | 8,930 | 14,200 | 8,300 |
| **Financed by:** |  |  |  |  |  |
| Capital receipts | 18 | 2,034 | 1,888 | 100 | - |
| Capital grants | 874 | 720 | 506 | 506 | 506 |
| Capital reserves | 4,041 | 1,291 | 3,526 | 742 | - |
| Revenue | 881 | - | - | - | - |
| Borrowing in advance of need | - | 30 | 3,011 | 7,059 | - |
| **Net financing need for the year** | **-** | **-** | **-** | **5,657** | **7,794** |

* + 1. 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 Commissioner to approve **an MRP Statement** in advance of each year. A variety of options are provided to councils and authorities, 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; 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); this options provide for a reduction in the borrowing need over approximately the asset’s life.
  + 1. 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:

**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.

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **%** | **2016/17**  **Actual** | **2017/18**  **Estimate** | **2018/19**  **Estimate** | **2019/20**  **Estimate** | **2020/21**  **Estimate** |
| Ratio | 0.8% | 0.8% | 0.8% | 0.8% | 0.9% |

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

* + 1. Treasury management limits on activity

There are two 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:

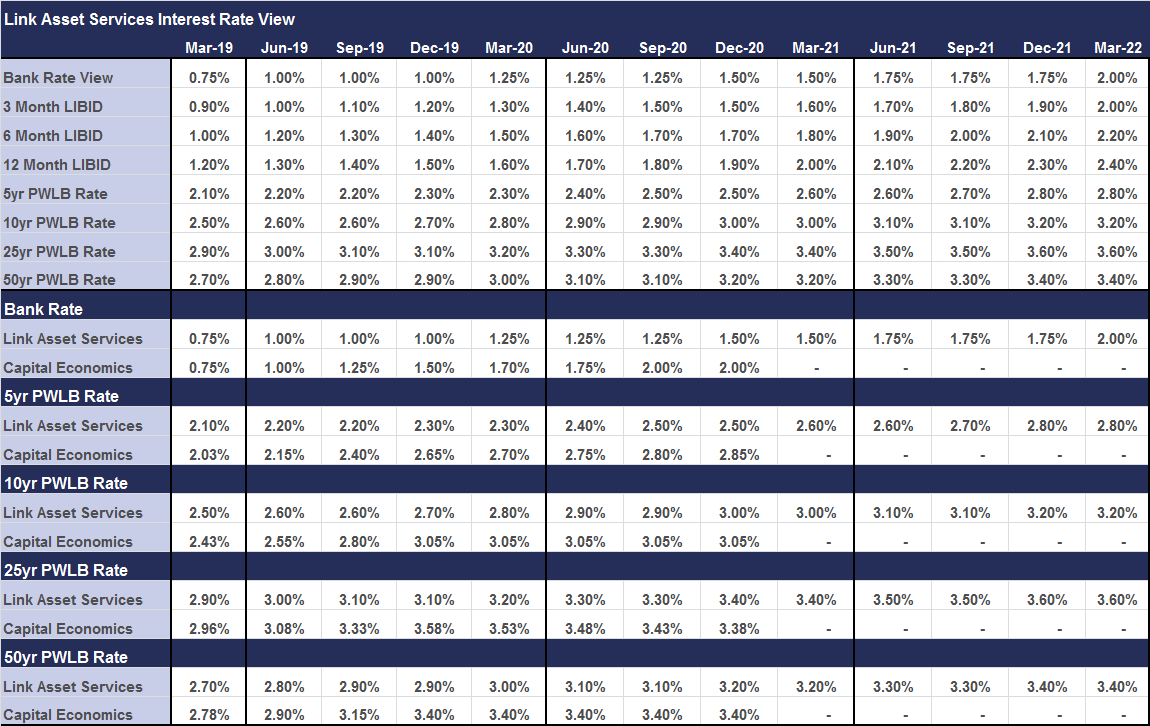
* Upper limits on fixed interest rate exposure. This identifies a maximum limit for fixed interest rates based upon the debt position net of investments
* Maturity structure of borrowing. These gross limits are set to reduce the Commissioner’s exposure to large fixed rate sums falling due for refinancing, and are required for upper and lower limits.

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

|  |  |  |  |
| --- | --- | --- | --- |
| **£000’s** | **2018/19** | **2019/20** | **2020/21** |
| **Interest rate exposures** | | | |
|  | **Upper** | **Upper** | **Upper** |
| **Limits on fixed interest rates based on net debt** | 23,494 | 23,003 | 22,489 |
| **Maturity structure of fixed interest rate borrowing 2018/19** | | | |
|  | | **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% |

* 2. APPENDIX: Interest Rate Forecasts 2019 - 2021

PWLB rates and forecast shown below have taken into account the 20 basis point certainty rate reduction effective as of the 1st November 2012.



* 1. APPENDIX: Economic Background

**GLOBAL OUTLOOK.** World growth has been doing reasonably well, aided by strong growth in the US. However, US growth is likely to fall back in 2019 and, together with weakening economic activity in China and the eurozone, overall world growth is likely to weaken.

**Inflation** has been weak during 2018 but, at long last, unemployment falling to remarkably low levels in the US and UK has led to a marked acceleration of wage inflation. The US Fed has therefore increased rates nine times and the Bank of England twice. However, the ECB is unlikely to start raising rates until late in 2019 at the earliest.

**KEY RISKS - central bank monetary policy measures**

Looking back on nearly ten years since the financial crash of 2008 when liquidity suddenly dried up in financial markets, it can be assessed that central banks’ monetary policy measures to counter the sharp world recession were successful. The key monetary policy measures they used were a combination of lowering central interest rates and flooding financial markets with liquidity, particularly through unconventional means such as quantitative easing (QE), where central banks bought large amounts of central government debt and smaller sums of other debt.

**The key issue now** is that that period of stimulating economic recovery and warding off the threat of deflation, is coming towards its close. A new period is well advanced in the US, and started more recently in the UK, of reversing those measures i.e. by raising central rates and, (for the US), reducing central banks’ holdings of government and other debt. These measures are now required in order to stop the trend of a reduction in spare capacity in the economy and of unemployment falling to such low levels, that the re-emergence of inflation is viewed as a major risk. It is, therefore, crucial that central banks get their timing right and do not cause shocks to market expectations that could destabilise financial markets. In particular, a key risk is that because QE-driven purchases of bonds drove up the price of government debt, and therefore caused a sharp drop in income yields, this also encouraged investors into a search for yield and into investing in riskier assets such as equities. Consequently, prices in both bond and equity markets rose to historically high valuation levels simultaneously. This meant that both asset categories were exposed to the risk of a sharp downward correction and we have indeed, seen a sharp fall in equity values in the last quarter of 2018. It is important, therefore, that central banks only gradually unwind their holdings of bonds in order to prevent destabilising the financial markets. It is also likely that the timeframe for central banks unwinding their holdings of QE debt purchases will be over several years. They need to balance their timing to neither squash economic recovery, by taking too rapid and too strong action, or, conversely, let inflation run away by taking action that was too slow and/or too weak. **The potential for central banks to get this timing and strength of action wrong are now key risks**. At the time of writing, (early January 2019), financial markets are very concerned that the Fed is being too aggressive with its policy for raising interest rates and was likely to cause a recession in the US economy.

The world economy also needs to adjust to a sharp change in **liquidity creation** over the last five years where the US has moved from boosting liquidity by QE purchases, to reducing its holdings of debt, (currently about $50bn per month). In addition, the European Central Bank ended its QE purchases in December 2018.

**UK.** The flow of positive economic statistics since the end of the first quarter of 2018 has shown that pessimism was overdone about the poor growth in quarter 1 when adverse weather caused a temporary downward blip. Quarter 1 at 0.1% growth in GDP was followed by a return to 0.4% in quarter 2 and by a strong performance in quarter 3 of +0.6%. However, growth in quarter 4 is expected to weaken significantly.

At their November quarterly Inflation Report meeting, the MPC repeated their well-worn phrase that future Bank Rate increases would be gradual and would rise to a much lower equilibrium rate, (where monetary policy is neither expansionary of contractionary), than before the crash; indeed they gave a figure for this of around 2.5% in ten years time, but declined to give a medium term forecast. However, with so much uncertainty around Brexit, they warned that the next move could be up or down, even if there was a disorderly Brexit. While it would be expected that Bank Rate could be cut if there was a significant fall in GDP growth as a result of a disorderly Brexit, so as to provide a stimulus to growth, they warned they could also raise Bank Rate in the same scenario if there was a boost to inflation from a devaluation of sterling, increases in import prices and more expensive goods produced in the UK replacing cheaper goods previously imported, and so on. In addition, the Chancellor could potentially provide fiscal stimulus to support economic growth, though at the cost of increasing the budget deficit above currently projected levels.

It is unlikely that the MPC would increase Bank Rate in February 2019, ahead of the deadline in March for Brexit. Getting parliamentary approval for a Brexit agreement on both sides of the Channel will take well into spring 2019. However, in view of the hawkish stance of the MPC at their November meeting, the next increase in Bank Rate is now forecast to be in May 2019, (on the assumption that a Brexit deal is agreed by both the UK and the EU). The following increases are then forecast to be in February and November 2020 before ending up at 2.0% in February 2022.

**Inflation.** The Consumer Price Index (CPI) measure of inflation has been falling from a peak of 3.1% in November 2017 to 2.3% in November. In the November Bank of England quarterly Inflation Report, inflation was forecast to still be marginally above its 2% inflation target two years ahead, (at about 2.1%), given a scenario of minimal increases in Bank Rate. This inflation forecast is likely to be amended upwards due to the Bank’s report being produced prior to the Chancellor’s announcement of a significant fiscal stimulus in the Budget; this is likely to add 0.3% to GDP growth at a time when there is little spare capacity left in the economy, particularly of labour.

As for the **labour market** figures in October, unemployment at 4.1% was marginally above a 43 year low of 4% on the Independent Labour Organisation measure. A combination of job vacancies hitting an all-time high, together with negligible growth in total employment numbers, indicates that employers are now having major difficulties filling job vacancies with suitable staff. It was therefore unsurprising that wage inflation picked up to 3.3%, (3 month average regular pay, excluding bonuses). This meant that in real terms, (i.e. wage rates less CPI inflation), earnings are currently growing by about 1.0%, the highest level since 2009. This increase in household spending power is likely to feed through into providing some support to the overall rate of economic growth in the coming months. This tends to confirm that the MPC was right to start on a cautious increase in Bank Rate in August as it views wage inflation in excess of 3% as increasing inflationary pressures within the UK economy.

In the **political arena**, there is a risk that the current Conservative minority government may be unable to muster a majority in the Commons over Brexit. However, our central position is that Prime Minister May’s government will endure, despite various setbacks, along the route to reaching an orderly Brexit in March 2019. If, however, the UK faces a general election in the next 12 months, this could result in a potential loosening of monetary and fiscal policy and therefore medium to longer dated gilt yields could rise on the expectation of a weak pound and concerns around inflation picking up.

**USA.** President Trump’s massive easing of fiscal policy is fuelling a, (temporary), boost in consumption which has generated an upturn in the rate of strong growth which rose from 2.2%, (annualised rate), in quarter 1 to 4.2% in quarter 2 and 3.5%, (3.0% y/y), in quarter 3, but also an upturn in inflationary pressures. The strong growth in employment numbers and the reduction in the unemployment rate to 3.9%, near to a recent 49 year low, has fed through to an upturn in wage inflation which hit 3.2% in November. However, CPI inflation overall fell to 2.2% in November and looks to be on a falling trend to drop below the Fed’s target of 2% during 2019. The Fed has continued on its series of increases in interest rates with another 0.25% increase in December to between 2.25% and 2.50%, this being the fifth increase in 2018 and the ninth in this cycle. However, they did also reduce their forecast for further increases from three to two. This latest increase compounded investor fears that the Fed is over doing the rate and level of increases in rates and that it is going to cause a US recession as a result. There is also much evidence in previous monetary policy cycles, of the Fed’s series of increases doing exactly that. Consequently, we have seen stock markets around the world plunging under the weight of fears around the Fed’s actions, the trade war between the US and China, an expectation that world growth will slow, Brexit etc.

The tariff war between the US and China has been generating a lot of heat during 2018, but it is not expected that the current level of actual action would have much in the way of a significant effect on US or world growth. However, there is a risk of escalation if an agreement is not reached soon between the US and China. The results of the mid-term elections are not expected to have a material effect on the economy.

**Eurozone.** Growth was 0.4% in quarters 1 and 2 but fell back to 0.2% in quarter 3, though this was probably just a temporary dip. In particular, data from Germany has been mixed and it could be negatively impacted by US tariffs on a significant part of manufacturing exports e.g. cars. For that reason, although growth is still expected to be in the region of nearly 2% for 2018, the horizon is less clear than it seemed just a short while ago. Having halved its quantitative easing purchases of debt in October 2018 to €15bn per month, the European Central Bank ended all further purchases in December 2018. The ECB is forecasting inflation to be a little below its 2% top limit through the next three years so it may find it difficult to warrant a start on raising rates by the end of 2019 if the growth rate of the EU economy is on a weakening trend.

**China.** Economic growth has been weakening over successive years, despite repeated 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. Progress has been made in reducing the rate of credit creation, particularly from the shadow banking sector, which is feeding through into lower economic growth. There are concerns that official economic statistics are inflating the published rate of growth.

**Japan.** Japan has been struggling to stimulate consistent significant GDP growth and 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. It is likely that loose monetary policy will endure for some years yet to try to stimulate growth and modest inflation.

**Emerging countries.** Argentina and Turkey are currently experiencing major headwinds

and are facing challenges in external financing requirements well in excess of their reserves of foreign exchange. However, these countries are small in terms of the overall world economy, (around 1% each), so the fallout from the expected recessions in these countries will be minimal.

**INTEREST RATE FORECASTS**

The interest rate forecasts provided by Link Asset Services in paragraph 3.2 are predicated on an assumption of an agreement being reached on Brexit between the UK and the EU. In the event of an orderly non-agreement exit, it is likely that the Bank of England would take action to cut Bank Rate from 0.75% in order to help economic growth deal with the adverse effects of this situation. This is also likely to cause short to medium term gilt yields to fall. If there was a disorderly Brexit, then any cut in Bank Rate would be likely to last for a longer period and also depress short and medium gilt yields correspondingly. It is also possible that the government could act to protect economic growth by implementing fiscal stimulus.

**The balance of risks to the UK**

* The overall balance of risks to economic growth in the UK is probably neutral.
* The balance of risks to increases in Bank Rate and shorter term PWLB rates, are probably also even and are broadly dependent on how strong GDP growth turns out, how slowly inflation pressures subside, and how quickly the Brexit negotiations move forward positively.

One risk that is both an upside and downside risk, is that all central banks are now working in very different economic conditions than before the 2008 financial crash as there has been a major increase in consumer and other debt due to the exceptionally low levels of borrowing rates that have prevailed for ten years since 2008. This means that the neutral rate of interest in an economy, (i.e. the rate that is neither expansionary nor deflationary), is difficult to determine definitively in this new environment, although central banks have made statements that they expect it to be much lower than before 2008. Central banks could therefore either over or under do increases in central interest rates.

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

* **Brexit** – if it were to cause significant economic disruption and a major downturn in the rate of growth.
* **Bank of England monetary policy** takes action too quickly, or too far, over the next three years to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than we currently anticipate.
* A resurgence of the **eurozone sovereign debt crisis**, possibly in **Italy**, due to its high level of government debt, low rate of economic growth and vulnerable banking system, and due to the election in March of a government which has made a lot of anti-austerity noise. The EU rejected the initial proposed Italian budget and demanded cuts in government spending which the Italian government initially refused. However, a fudge was subsequently agreed but only by delaying the planned increases in expenditure to a later year. This can has therefore only been kicked down the road to a later time. The rating agencies have started on downgrading Italian debt to one notch above junk level. If Italian debt were to fall below investment grade, many investors would be unable to hold it. Unsurprisingly, investors are becoming increasingly concerned by the words and actions of the Italian government and consequently, Italian bond yields have risen – at a time when the government faces having to refinance large amounts of debt maturing in 2019.
* Weak capitalisation of some **European banks**. Italian banks are particularly vulnerable; one factor is that they hold a high level of Italian government debt - debt which is falling in value. This is therefore undermining their capital ratios and raises the question of whether they will need to raise fresh capital to plug the gap.
* **German minority government.** In the German general election of September 2017, Angela Merkel’s CDU party was left in a vulnerable minority position dependent on the fractious support of the SPD party, as a result of the rise in popularity of the anti-immigration AfD party. Then in October 2018, the results of the Bavarian and Hesse state elections radically undermined the SPD party and showed a sharp fall in support for the CDU. As a result, the SPD is reviewing whether it can continue to support a coalition that is so damaging to its electoral popularity. After the result of the Hesse state election, Angela Merkel announced that she would not stand for re-election as CDU party leader at her party’s convention in December 2018, (a new party leader has now been elected). However, this makes little practical difference as she is still expected to aim to continue for now as the Chancellor. However, there are five more state elections coming up in 2019 and EU parliamentary elections in May/June; these could result in a further loss of electoral support for both the CDU and SPD which could also undermine her leadership.
* **Other minority eurozone governments.** Spain, Portugal, Ireland, the Netherlands and Belgium all have vulnerable minority governments dependent on coalitions which could prove fragile. Sweden is also struggling to form a government due to the anti-immigration party holding the balance of power, and which no other party is willing to form a coalition with. The Belgian coalition collapsed in December 2018 but a minority caretaker government has been appointed until the May EU wide general elections.
* **Austria, the Czech Republic and Hungary** now form a strongly anti-immigration bloc within the EU while **Italy**, this year, has also elected a strongly anti-immigration government. Elections to the EU parliament are due in May/June 2019.
* Further increases in interest rates in the US could spark a **sudden flight of investment funds** from more risky assets e.g. shares, into bonds yielding a much improved yield. Throughout the last quarter of 2018, we saw a sharp fall in equity markets but this has been limited, as yet. Emerging countries which have borrowed heavily in dollar denominated debt, could be particularly exposed to this risk of an investor flight to safe havens e.g. UK gilts.
* There are concerns around the level of **US corporate debt** which has swollen massively during the period of low borrowing rates in order to finance mergers and acquisitions. This has resulted in the debt of many large corporations being downgraded to a BBB credit rating, close to junk status. Indeed, 48% of total investment grade corporate debt is now rated at BBB. If such corporations fail to generate profits and cash flow to reduce their debt levels as expected, this could tip their debt into junk ratings which will increase their cost of financing and further negatively impact profits and cash flow.
* **Geopolitical risks**, especially North Korea, but also in Europe and the Middle East, which could lead to increasing safe haven flows.

**Upside risks to current forecasts for UK gilt yields and PWLB rates**

* **Brexit** – if both sides were to agree a compromise that removed all threats of economic and political disruption.
* **The Fed causing a sudden shock in financial markets** through misjudging the pace and strength of increases in its Fed Funds Rate and in the pace and strength of reversal of QE, which then leads to a fundamental reassessment by investors of the relative risks of holding bonds, as opposed to equities. This could lead to a major flight from bonds to equities and a sharp increase in bond yields in the US, which could then spill over into impacting bond yields around the world.
* The **Bank of England is too slow** in its pace and strength of increases in Bank Rate and, therefore, allows inflation pressures to build up too strongly within the UK economy, which then necessitates a later rapid series of increases in Bank Rate faster than we currently expect.
* **UK inflation**, whether domestically generated or imported, returning to sustained significantly higher levels causing an increase in the inflation premium inherent to gilt yields.
  1. APPENDIX: Treasury Management Practice (TMP1) – Credit and Counterparty Risk Management

The MHCLG issued Investment Guidance in 2018, 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 councils and authorities to invest prudently, and that priority is given to security and liquidity before yield. In order to facilitate this objective the guidance requires the 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 February 2006 and the Commissioner will apply its principles to all investment activity. In accordance with the Code, the Director of Finance has produced the 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.
* Non-specified investments, clarifying the greater risk implications, identifying the general types of investment that may be used and a limit to the overall amount of various categories that can be held at any time.

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, housing association, parish council or community council.
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 (such as a bank or building society). 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. These criteria are set out below:

|  |  |  |  |
| --- | --- | --- | --- |
|  | **Fitch Long Term Rating** | **Money and/or % Limit** | **Time Limit** |
| Banks 1 - higher quality | A- / F1 (Short term) | 25% of available funds up to £10m per institution | 364 days |
| Banks 2 – part nationalised | A- / F1 (Short term) | 25% of available funds up to £10m per institution | 364 days |
| Limit 3 category – Commissioner’s banker (not meeting Banks 1) |  | £10m | Overnight |
| DMADF | AAA | unlimited | 6 months |
| Local authorities | N/A | £10m | 364 days |
|  | **Fund rating** | **Money and/or % Limit** | **Time Limit** |
| Money market funds CNAV | AAA | 100% of available funds | Liquid |
| Money market funds LVNAV | AAA | 100% of available funds | Liquid |
| Money market funds VNAV | AAA | 100% of available funds | Liquid |
| Ultra-Short Dated Bonds Funds | AAA | 100% of available 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 Link Asset Services as and when ratings change, and counterparties are checked promptly. 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 Chief Constable’s CFO, and if required new counterparties which meet the criteria will be added to the list.

* 1. 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.
  1. 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.