Warwickshire and West Mercia Police and Crime Commissioners Treasury Management Strategy 2018/19

Report of the Treasurer

Recommendations

That:

a) the Treasury Management Strategy and Investment Strategy for 2018/19 be approved by the Police and Crime Commissioners for Warwickshire and West Mercia

b) the Prudential Indicators agreed as part of the respective budget settings (see **Appendices A and B** are noted;

c) the Commissioners require the Treasurer to ensure that net borrowing does not exceed the Prudential levels specified in **Appendices A and B,** taking into account current commitments, existing plans, and the proposals agreed in the budget reports;

d) the Commissioners delegate authority to the Treasurer to undertake all the activities listed in **Appendix C** of the report;

e) the Treasurer implements the Minimum Revenue Provision Policy as specified in **Appendix A and B**.

1 Introduction

Background

1.1 Treasury management is defined, in a local government context, 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 Each 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 a low risk appetite, providing security of capital and sufficient liquidity initially before considering investment return.

1.3 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 his 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 occasions, debt previously drawn may be restructured to meet the Commissioner's risk or cost objectives.

Statutory Requirements

1.4 Each Commissioner has a statutory obligation under the Local Government Act 2003 to have regard to the CIPFA Prudential Code and the CIPFA Treasury Management Code of Practice to set Prudential and Treasury Indicators for the next three years to ensure that the Authority's capital investment plans are affordable, prudent and sustainable.

1.5 The Commissioners are required, therefore, to set out their treasury strategy for borrowing and to prepare an Annual Investment Strategy. This sets out the policies for managing their investments and for giving priority to the security and liquidity of those investments

CIPFA Requirements

1.6 The Chartered Institute of Public Finance and Accountancy's (CIPFA) is responsible for publishing and maintaining the Code of Practice on Treasury Management with which the Commissioner is obliged to comply.

1.7 The primary requirements of the Code are as follows:

a. Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Commissioners' treasury management activities.
b. Creation and maintenance of Treasury Management Practices which set out the manner in which the Commissioner will seek to achieve those policies and objectives.
c. Receipt by the Commissioners of an annual Treasury Management Strategy Statement - including the Annual Investment Strategy and Minimum Revenue Provision Policy - for the year ahead, a Mid-year Review Report and an Annual Report (stewardship report) covering activities during the previous year.
d. Delegation by each Commissioner of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.
e. Delegation by each Commissioner of the role of scrutiny of treasury management strategy and policies to a specific named body. In this respect the Commissioners have chosen to delegate this responsibility to the Joint Audit Committee

1.8 The suggested strategy for 2018/19 in respect of the following aspects of the treasury management function is based upon the Treasurer's and the Force Accounting and Financial Services Team's (who undertake treasury management on behalf of the Commissioner) views on interest rates, supplemented with leading market forecasts provided by treasury advisers.

1.9 The strategy covers:

- Treasury limits for 2018/19 to 2021/22
- Prudential indicators
- External and local content
- Borrowing strategy
- Debt rescheduling
- Annual investment strategy
- Minimum Revenue Provision (MRP) strategy

1.10 In accordance with the CLG Guidance, the Commissioners will be asked to approve a revised Treasury Management Strategy Statement should the assumptions on which this report is based change significantly. Such circumstances would include, for example, a large unexpected change in interest rates, or in the Commissioners capital programme or in the level of its investment balance.

2 Treasury Limits for 2018/19 to 2021/22

2.1 Each Commissioner is required to determine and keep under review how much they can afford to borrow. The amount so determined is termed the “Affordable Borrowing Limit”. In England and Wales, the Authorised Limit represents the legislative limit specified in the Local Government Act 2003.

2.2 The Commissioners must have regard to the Prudential Code when setting the Authorised Limit, which essentially requires them to ensure that total capital investment remains within sustainable limits and, in particular, that the impact upon future council tax levels is ‘acceptable’.

2.3 Termed an “Affordable Borrowing Limit”, the capital plans to be considered for inclusion in corporate financing consists of both external borrowing and other forms of liability, such as credit arrangements. The Authorised Limit is to be set, on a rolling basis, for the forthcoming financial year and two successive financial years. Details of the Authorised Limit can be found in **Appendices A and B** of this report.

2.4 The Commissioners’ current treasury portfolios are as follows:

Warwickshire

Treasury Portfolio at 31st January 2018	**Principal £m**	**Average Rate %**
Fixed Rate Funding Public Works Loans Board	14.0	5.0
Investments In House Externally Managed	11.0 0.0	0.23 0.00

Net Debt	3.0	

West Mercia

Treasury Portfolio at 31st January 2018	**Principal £m**	**Average Rate %**
Fixed Rate Funding Public Works Loans Board	 10.0	 4.44
Investments In House Externally Managed	 7.00 0.0	 0.18 0.00
Net Debt	(3.0)	

2.5 The Commissioners' borrowing requirements are as follows:

Warwickshire

Borrowing Requirement	**16/17 Actual £m**	**17/18 Estimate £m**	**18/19 Estimate £m**	**19/20 Estimate £m**	**20/21 Estimate £m**	**21/22 Estimate £m**
New borrowing	0.0	5.9	4.0	3.3	4.5	2.8
Replacement borrowing	0.0	0.0	0.0	0.0	0.0	0.0
Total	**0.0**	**5.9**	**4.0**	**4.1**	**5.4**	**2.8**

West Mercia

Borrowing Requirement	**16/17 Actual £m**	**17/18 Estimate £m**	**18/19 Estimate £m**	**19/20 Estimate £m**	**20/21 Estimate £m**	**21/22 Estimate £m**
New borrowing	0.0	11.1	7.4	9.6	14.9	4.5
Replacement borrowing	0.0	0.0	0.0	0.0	0.0	0.0
Total	**0.0**	**11.1**	**7.4**	**9.6**	**14.9**	**4.5**

This will be through either internal or external borrowing

3 Prudential Indicators for 2018/19 to 2019/20

3.1 Prudential and Treasury Indicators (Appendices A & B to this report) are relevant for the purpose of setting an integrated treasury management strategy.

3.2 The indicators are based on the currently agreed capital programme.

4 The External Context

Economic background:

The major external influence on the Commissioners' treasury management strategy for 2018/19 will be the UK's progress in negotiating its exit from the European Union and agreeing future trading arrangements. The domestic economy has remained relatively robust since the surprise outcome of the 2016 referendum, but there are indications that uncertainty over the future is now weighing on growth. Transitional arrangements may prevent a cliff-edge, but will also extend the period of uncertainty for several years. Economic growth is therefore forecast to remain sluggish throughout 2018/19.

Consumer price inflation reached 3.0% in September 2018 as the post-referendum devaluation of sterling continued to feed through to imports. Unemployment continued to fall and the Bank of England's Monetary Policy Committee judged that the extent of spare capacity in the economy seemed limited and the pace at which the economy can grow without generating inflationary pressure had fallen over recent years. With its inflation-control mandate in mind, the Bank of England's Monetary Policy Committee raised official interest rates to 0.5% in November 2018.

In contrast, the US economy is performing well and the Federal Reserve is raising interest rates in regular steps to remove some of the emergency monetary stimulus it has provided for the past decade. The European Central Bank is yet to raise rates, but has started to taper its quantitative easing programme, signalling some confidence in the Eurozone economy.

4.1 Credit Outlook

High profile bank failures in Italy and Portugal have reinforced concerns over the health of the European banking sector. Sluggish economies and fines for pre-crisis behaviour continue to weigh on bank profits, and any future economic slowdown will exacerbate concerns in this regard.

Bail-in legislation, which ensures that large investors including local authorities will rescue failing banks instead of taxpayers in the future, has now been fully implemented in the European Union, Switzerland and USA, while Australia and Canada are progressing with their own plans. In addition, the largest UK banks will ringfence their retail banking functions into separate legal entities during 2018. There remains some uncertainty over how these changes will impact upon the credit strength of the residual legal entities.

The credit risk associated with making unsecured bank deposits has therefore increased relative to the risk of other investment options available to the both Commissioners; returns from cash deposits however remain very low.

4.2 Interest Rate Forecast

The Commissioners' treasury adviser Arlingclose's central case is for UK Bank Rate to remain at 0.50% during 2018/19**,** following the rise from the historic low of 0.25%. The Monetary Policy Committee re-emphasised that any prospective increases in Bank Rate would be expected to be at a gradual pace and to a limited extent.

Future expectations for higher short term interest rates are subdued and on-going decisions remain data dependant and negotiations on exiting the EU cast a shadow over monetary policy decisions. The risks to Arlingclose's forecast are broadly balanced on both sides. The Arlingclose central case is for gilt yields to remain broadly stable across the medium term. Upward movement will be limited, although the UK government's seemingly deteriorating fiscal stance is an upside risk.

For the purpose of setting the budget, it has been assumed that new investments will be made at an average rate of 0.23% for Warwickshire and 0.18% for West Mercia. It has been assumed for budgeting purposes that any new long-term loans for West Mercia will be borrowed at an average rate of 2.67%, based on the 25 year PWLB rate at the end of October 2017.

4.3 MiFID2

A key change required by the new Treasury Management code is to set out the position in relation to the Markets in Financial Instruments Directive II (MiFID II) that came into effect on 3 January 2018. Under MiFID II all local authorities are automatically classed as retail clients in relation to investments, which may restrict the availability of some types of investments used in treasury management. The Financial Conduct Authority have set rules under which local authorities can "opt up" to elective professional client status, which would then enable them to continue to access investments such as money market funds and property funds.

The PCC for both Warwickshire and West Mercia have elected for professional client status. To remain as a professional client each Commissioner requires an investment portfolio of at least £10m. The invest portfolio will be closely monitored during 2018/2019 ensuring that the portfolio is classified correctly.

5 Local Context in Warwickshire and West Mercia

5.1 Warwickshire

It is estimated that as at 31st March 2018 Warwickshire will hold £14.0m of borrowing and £11m of investments. This is set out in further detail at **Appendix A**. Forecast changes in these sums are shown in the balance sheet analysis in table 5.1.

It is estimated that the amount of investments held during 2018/2019 will be rising during the course of the year as the precept income is received in 10 monthly instalments and then significantly when the Home Office pays the police pension top up grant which is estimated at £ 15.8m. This will increase the Commissioner cash flow to £ 14.3m by the Summer 2018.

Table 5.1 Balance Sheet Summary and Forecast

Warwickshire	**31.03.17 Actual £m**	**31.03.18 Forecast £m**	**31.03.19 Forecast £m**	**31.03.20 Forecast £m**	**31.03.21 Forecast £m**
Borrowing CFR	20.5	25.9	29.0	31.3	34.6
Less: External Borrowing**	14.9	14.0	17.1	19.4	22.9
Internal (over) Borrowing	5.6	11.9	11.9	11.9	11.7
Less: Usable Reserves	(26.0)	(16.7)	(9.5)	(7.0)	(6.9)
Less: Working Capital	(3.7)	(6.2)	(2.4)	(4.9)	(4.8)
Investments	24.1	11.0	0.0	0.0	0.0

** Shows loans to which the Commissioner is committed and potential loans required in future years to fund capital expenditure. Short-term loans may also be required for cashflow purposes.

5.2 West Mercia

It is estimated that at the 31st March 2018 that West Mercia will hold £10m of borrowing and £2.0m of investments. This is set out in further detail at **Appendix B**. Forecast changes in these sums are shown in the balance sheet analysis in table 5.2.

It is estimated that the amount of investments held during 2018/2019 will be rising during the course of the year as the precept income is received in 10 monthly instalments and then significantly when the Home Office pays the police pension top up grant which is estimated at £ 28.3m. This will increase the Commissioner cash flow to £ 25.7m by the Summer 2018

Table 5.2 Balance Sheet Summary and Forecast

West Mercia	31.03.17 Actual £m	31.03.18 Forecast £m	31.03.19 Forecast £m	31.03.20 Forecast £m	31.03.21 Forecast £m
Borrowing CFR	30.7	40.5	46.5	54.2	67.1
Less: External Borrowing**	10.0	13.0	20.4	30.0	44.9
Internal (over) Borrowing	20.7	27.5	26.1	24.2	22.2
Less: Usable Reserves	(53.5)	(34.9)	(20.8)	(13.3)	(13.0)
Less: Working Capital	12.4	2.1	(5.3)	(10.9)	(9.2)
Investments	20.4	5.0	0.0	0.0	0.0

** Shows loans to which the Commissioner is committed and potential loans required in future years to fund capital expenditure. Assumes new loans of £3m required in 2017/18, depending on cashflow requirements; further loans may also be required to "externalise" internal borrowing as revenue reserves are used and surplus cash is depleted (see borrowing strategy below).

5.3 The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. The Commissioners' current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing.

The capital expenditure plans imply that there is a need to borrow over the forecast period. Investments are forecast to fall as capital receipts are used to finance capital expenditure and reserves are used to finance the revenue budget and capital expenditure.

CIPFA's Prudential Code for Capital Finance in Local Authorities recommends that the Commissioners total debt should be lower than its highest CFR forecast over the next three years.

6 Borrowing Strategy

6.1 Both Commissioners are 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 Commissioners' reserves, balances and cash flow has been used as a temporary measure. Warwickshire as at 31st March 2018 will have £11.9m of internal borrowing and West Mercia £27.5m. This strategy is prudent as investment returns are low and counterparty risk is high. Against this background and the risks within the economic forecast, caution will be adopted with the 2018/19 treasury operations. From 2018/19 onwards as the revenue reserves are used, there will be a need for the Commissioners to borrow funds to "externalise" previous internal borrowing, as well as to fund the future capital programme. Increased capital financing costs have been built into the revenue budget to take account of this position. The Treasury Team will carefully monitor interest rates in financial markets and the cashflow requirements of both Commissioners and adopt a pragmatic approach to changing circumstances. Any borrowing decisions required will be reported to the Commissioners at the earliest available opportunity.

6.2 Warwickshire currently holds £14.0 million of loans. The balance sheet forecast in table 5.1 shows that there is a borrowing requirement for 2018/19 of £4.0m. The Commissioner may however borrow to pre-fund future years' requirements, providing this does not exceed the authorised limit for borrowing of £40m.

West Mercia currently holds £10.0 million of loans. The balance sheet forecast in table 5.2 shows that there is a borrowing requirement for 2018/19 of £7.4m. The Commissioner may however borrow to pre-fund future years' requirements, providing this does not exceed the authorised limit for borrowing of £60m. The Commissioner may also need to borrow to "externalise" some internal borrowing that has built up over previous years. It is expected that revenue reserves of £14m will be used in 2018/19 which will have an impact on cashflow. The exact timing of the borrowing and the length of borrowing required will depend on the timing of cash outflows and the revenue outturn position.

6.3 The Commissioners' chief objective when borrowing money will always be to strike an appropriately low risk balance between securing low interest costs and achieving certainty of those costs over the period for which funds are required. The flexibility to renegotiate loans should the Commissioners' long-term plans change is a secondary objective.

6.4 Given the significant cuts to public expenditure, though these have been mitigated in part by increasing flexibility in on Council Tax for 2018/19 and 2019/20.
Each Commissioner's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. With short-term interest rates currently much lower than long-term rates, it is likely to be more cost effective in the short-term to either use internal resources, or to borrow short-term loans instead.

By doing so, each Commissioner is able to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk. The benefits of internal and/or short-term borrowing will be monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing rates are forecast to rise modestly. Arlingclose will assist each Commissioner with this 'cost of carry' and breakeven analysis. Its output may determine whether the Commissioner borrows additional sums at long-term fixed rates in 2018/19 with a view to keeping future interest costs low, even if this causes additional cost in the short-term.

Alternatively, each Commissioner may arrange forward starting loans during 2018/19, where the interest rate is fixed in advance, but the cash is received in later years. This would enable certainty of cost to be achieved without suffering a cost of carry in the intervening period.

In addition, the Commissioners may borrow short-term loans to cover unplanned cash flow shortages.

Sources of borrowing:

The approved sources of long-term and short-term borrowing are:

- Public Works Loan Board (PWLB) and any successor body;
- any institution approved for investments;
- any other bank or building society authorised to operate in the UK;
- UK public and private sector pension funds (except Worcestershire County Council and Warwickshire County Council Pension Fund);
- capital market bond investors.

6.5 The Arlingclose forecasts for the PWLB new borrowing rates are as follows:

Date	**PWLB Certainty Rate**			
	5 Year	10 Year	20 Year	50 Year
01/03/2018	1.95	2.45	2.8	2.6
01/06/2018	2.15	2.6	2.9	2.75
01/09/2018	2.2	2.65	2.95	2.8
01/12/2018	2.3	2.7	2.95	2.8
01/03/2019	2.35	2.8	3	2.85
01/06/2019	2.4	2.85	3.05	2.9
01/09/2019	2.45	2.9	3.05	2.9
01/12/2019	2.5	2.95	3	2.85
01/03/2020	2.5	2.95	2.95	2.8
01/06/2020	2.5	2.95	3	2.85
01/09/2020	2.45	2.85	3	2.85
01/12/2020	2.45	2.85	3	2.85
01/03/2021	2.45	2.85	3	2.85

6.6 In view of the above forecast, the Commissioners' borrowing strategy will be based upon the following:

- The cheapest borrowing will be internal borrowing by running down cash balances and foregoing interest earned at historically low rates;
- Internal borrowing will be weighed against potential long-term costs that will be incurred if market loans at long-term rates are higher in future years;
- Long-term fixed rate market loans at rates significantly below PWLB rates for the equivalent maturity period (where available) and to maintaining an appropriate balance between PWLB and market debt in the debt portfolio;
- PWLB borrowing for periods under ten years where rates are expected to be significantly lower than rates for longer periods. This offers a range of options for new borrowing, which will spread debt maturities away from a current concentration in longer dated debt.

In addition, it is important to note that both Commissioners will seek to minimise their future borrowings by using revenue budget underspends to defray borrowing where this is feasible and prudent.

6.7 In normal circumstances, the main sensitivities of the forecast are likely to be the two scenarios noted below. The Treasurer, in conjunction with the Chief Financial Officer and the treasury advisors, will continually monitor both the prevailing interest rates and the market forecasts, adopting the following responses to a change of sentiment:

- If it were 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 the 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 were felt that there was a significant risk of a much sharper rise in long and short term rates than that currently forecast, perhaps arising from a greater than expected increase in world economic activity or a sudden increase in inflation risks, then the portfolio position will be reappraised with the likely action that fixed rate funding will be drawn whilst interest rates were still relatively cheap.

6.8 Policy on borrowing in advance of need

The Commissioners will not borrow more than or in advance of its needs purely in order profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be considered carefully to ensure value for money can be demonstrated and that the Commissioners can ensure the security of such funds.

In determining whether borrowing will be undertaken in advance of need, the Commissioners will:

- Ensure that there is a clear link between the capital programme and maturity profits of the existing debt portfolio which supports the need to take funding in advance of need;
- ensure the ongoing revenue liabilities created, and the implications for the future plans and budgets have been considered;
- evaluate the economic and market factors that might influence the manner and timing of any decision to borrow;
- consider the merits and demerits of alternative forms of funding;
- consider the alternative interest rate bases available, the most appropriate periods to fund and repayment profiles to use;
- consider the impact of borrowing in advance of temporarily (until required to finance capital expenditure) increasing investment cash balances and the consequent increase in exposure to counterparty risk, and other risks, and the level of such risks given the controls in place to minimise them.

7. Debt Rescheduling

7.1 PWLB debt restructuring is now much less financially attractive than it used to be. Consideration is given to the large premiums incurred by prematurely repaying existing PWLB loans. It is very unlikely that these could be justified on value for money grounds if using replacement PWLB refinancing, although other market loans may be available as the source of replacement financing.

7.2 As short term borrowing rates will be considerably cheaper than longer term rates, there could be significant 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 their short term nature and the likely cost of refinancing those short term loans, once they mature, compared with the current rates of longer term debt in the existing debt portfolio.

7.3 The reason for any rescheduling to take place will include:

- the generation of cash savings and discounted cash flow savings;
- helping to fulfil the strategy outlined in Section 5 above, and
- enhancing the balance of the portfolio (amending the maturity profile and / or the balance of volatility)

7.4 Consideration will also be given to identify if there is any residual potential left 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.

8. Annual Investment Strategy

Investment Policy

8.1 The Commissioners will have regard to the DCLG's Guidance on Local Government Investments ("the Guidance") and the 2011 revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("CIPFA TM Code").

Both the CIPFA Code and the CLG Guidance requires each commissioner to invest their funds prudently, and to have regard to the security and liquidity of their investments before seeking the highest rate of return, or yield. The Commissioners' objectives when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income. Where balances are expected to be invested for more than one year, the Commissioner will aim to achieve a total return that is equal or higher than the prevailing rate of inflation, in order to maintain the spending power of the sum invested.

8.2 The Commissioners' investment priorities are the security of capital and the liquidity of investments.

8.3 The Commissioners will also aim to achieve the optimum return on his investments, commensurate with proper levels of security and liquidity. The risk appetites of the Commissioners are extremely low in order to give overriding and absolute priority to the security of their investments.

8.4 In accordance with the above, and in order to minimise the risk to investments, the Commissioners have below stipulated the minimum acceptable credit quality of counterparties for inclusion on the lending list. The creditworthiness methodology used to create the counterparty list takes account of the ratings and watches published by all three ratings agencies, with a full understanding of what the ratings represent. Using information from Arlingclose, service banks' ratings are monitored on a real time basis with knowledge of any changes notified electronically as the agencies notify modifications.

8.5 Furthermore, the Commissioners' officers recognise that ratings should not be the sole determinant of the quality of an institution and that it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which the institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To this end the Commissioners' officers will engage with the advisors, Arlingclose, to monitor market pricing and overlay that information on top of the credit ratings.

8.6 Other information sources used will include the financial press, share price and other such information pertaining to the banking sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties. The aim of the strategy is to generate a list of highly creditworthy counterparties which will also enable diversification and thus avoidance of concentration risk. The intention of the strategy is to provide security of investment and minimisation of risk.

8.7 Given the increasing risk and very low returns from short-term unsecured bank investments, each Commissioner may further diversify into more secure and/or higher yielding asset classes during 2018/19. However, this is more appropriate for surplus funds that the Commissioners may hold that are available for longer-term investment. Due to the lower levels of a cash that are expected to be available for investment, as set out in the tables in Section 5, it is unlikely that longer-term investment will be made. All of the Commissioners' surplus cash remains invested in short-term unsecured bank deposits.

8.8 The Commissioners may invest their surplus funds with any of the counterparty types shown in the respective tables below, subject to the cash limits (per counterparty) and the time limits shown.

Table 8.8 Approved Investment Counterparts and Limits.

Approved Counterparty Limits for Warwickshire

Credit Rating	Banks Unsecured and Secured	Government (Incl. Local Authorities)	Registered Providers (Housing Associations)
UK Govt.	N/A	£ Unlimited 50 years	N/A
AAA, AA+,	£2m	£3m	£2m

AA, AA-	3 Years	3 Years	3 Years
A+	£2m 2 Years	£2m 2 Years	£2m 2 Years
A	£2m 13 Months	£2m 2 Years	£2m 2 Years
A-	£2m 6 Months	£2m 2 Years	£2m 2 Years
UK Building Societies without Credit Ratings	£1m 6 Months	N/A	N/A
UK Local Authorities (and PCCs) without credit ratings	N/A	£3m 3 Years	N/A
Money Market Funds	£2M Per Fund		
Current Account Bank (Lloyds) if the credit rating is A- or above	£5m 1 Year	N/A	N/A
Current Account Bank (Lloyds) if it fails to meet the above criteria	£1m Next Working Day	N/A	N/A

Approved Counterparty Limits for West Mercia

Credit Rating	**Banks Unsecured and Secured**	**Government (Incl. Local Authorities)**	**Registered Providers (Housing Associations)**
UK Govt.	N/A	£ Unlimited 50 years	N/A
AAA, AA+, AA, AA-	£3m 3 Years	£5m 3 Years	£3m 3 Years
A+	£3m 2 Years	£3m 2 Years	£3m 2 Years
A	£3m 13 Months	£3m 2 Years	£3m 2 Years
A-	£3m 6 Months	£3m 2 Years	£3m 2 Years
UK Building Societies without Credit Ratings	£2m 6 Months	N/A	N/A
UK Local Authorities (and) PCCs without	N/A	£5m 3 Years	N/A

credit ratings			
Money Market Funds	£3m Per Fund		
Current Account Bank (HSBC) if the credit rating is A- or above	£5m 1 Year	N/A	N/A
Current Account Bank (HSBC) if it fails to meet the above criteria	£1m Next Working Day	N/A	N/A

The tables above must be read in conjunction with the notes below:

a) Investment limits are set by reference to the lowest published long-term credit rating from Fitch, Moody's or Standard & Poor's. Where available, the credit rating relevant to the specific investment or class of investment is used, or otherwise the counterparty credit ratting is used. However, investment decisions are never made solely based on credit ratings, and all other relevant factors including external advice will be taken into account.

b) Accounts, deposits, certificates of deposit and senior unsecured bonds with banks and building societies, other than multilateral development banks. These investments are subject to the risk of credit loss via a bail-in should the regulator determine that the bank is failing or likely to fail.

c) Covered bonds, reverse purchase agreements and other collaterised arrangements with banks and building societies. These investments are secured on the bank's assets, which limits the potential losses in the unlikely event of insolvency, and means that they are exempt from bail-in. Where there is no investment specific credit rating, but the collateral upon which the investment is secured has a credit rating, the higher of the collateral credit rating and the counterparty credit rating will be used to determine cash and time limits. The combined secured and unsecured investments in any one bank will not exceed the cash limit for secured investments.

d) Loans, bonds and bills issued or guaranteed by national governments, regional and local authorities and multilateral development banks. These investments are not subject to bail-in, and there is an insignificant risk of insolvency. Investments with the UK Central Government may be made in unlimited amounts for up to 50 years.

e) Loans and bonds issued by, guaranteed by or secured on the assets of Registered Providers of Social Housing, formerly known as Housing Associations. These bodies are tightly regulated by the Homes and Communities Agency and, as providers of public services, they retain the likelihood of receiving government support if needed.

f) Shares in diversified investment vehicles consisting of the any of the above investment types, plus equity shares and property. These funds have the advantage of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a fee. Short-term Money Market Funds that offer same-day liquidity and very low or no volatility will be used as an alternative to instant access bank accounts, while pooled funds whose value changes with market prices and/or have a notice period will be used for longer investment periods.

g) Bond, equity and property funds offer enhanced returns over the longer term, but are more volatile in the short term. These allow the Commissioners to diversify into asset classes other than cash without the need to own and manage the underlying investments. Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Commissioners' investment objectives will be reviewed regularly.

h) Operational bank accounts: The Commissioner may incur operational exposures, for example though current accounts, collection accounts and merchant acquiring services, to any UK bank with credit ratings no lower than BBB- and with assets greater than £25 billion. These are not classed as investments, but are still subject to the risk of a bank bail-in, and balances will therefore be kept below £5,000,000 per bank. The Bank of England has stated that in the event of failure, banks with assets greater than £25 billion are more likely to be bailed-in than made insolvent, increasing the chance of the Authority maintaining operational continuity.

8.9 Warwickshire is expected to have £11m invested funds as at 31 March 2018, representing income received in advance of expenditure plus balances and reserves held. In the past 12 months, Warwickshire's investment balance has ranged between £13 and £36.5 million. The balance as at 31 March 2017 was much higher (£28m) and therefore, taking into account the budgeted use of revenue reserves during 2018/19, it is expected that the levels of surplus cash available to invest will be lower in the forthcoming year. This will, however be dependant on the amount of external borrowing the year.

West Mercia is expected to have between £2m and £5m of invested funds as at 31 March 2018 (depending on any short-term borrowing decisions that may be made), representing income received in advance of expenditure plus balances and reserves held. In the past 12 months, West Mercia's investment balance has ranged between £10 and £51 million. The balance as at 31 March 2017 was much higher (£20m) and therefore, taking into account the budgeted use of revenue reserves during 2018/19, it is expected that the levels of surplus cash available to invest will be lower in the forthcoming year, with a potential need for short-term borrowing at certain times during the year. This will, however be dependant on the amount of external borrowing the year.

8.10 Risk Assessment and Credit Ratings:

Credit ratings are obtained and monitored by the Commissioners' treasury advisers, who will notify changes in ratings as they occur. Where an entity has its credit rating downgraded so that it fails to meet the approved investment criteria then:

- no new investments will be made;
- any existing investments that can be recalled or sold at no cost will be; and
- full consideration will be given to the recall or sale of all other existing investments with the affected counterparty.

Where a credit rating agency announces that a credit rating is on review for possible downgrade (also known as “rating watch negative” or “credit watch negative”) so that it may fall below the approved rating criteria, then only investments that can be withdrawn [on the next working day] will be made with that organisation until the outcome of the review is announced. This policy will not apply to negative outlooks, which indicate a long-term direction of travel rather than an imminent change of rating.

The Commissioners understand that credit ratings are good, but not perfect, predictors of investment default. As stated, also full regard will therefore be given to other available information on the credit quality of the organisations, in which it invests, including credit default swap prices, financial statements, information on potential government support and reports in the quality financial press. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may meet the credit rating criteria.

When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008 and 2011, this is not generally reflected in credit Commissioners ratings, but can be seen in other market measurers. In these circumstances, the will restrict its investments to those organisations of higher credit quality and reduce the maximum duration of its investments to maintain the required level of security. The extent of these restrictions will be in line with prevailing financial market conditions. It these restrictions mean the insufficient commercial organisations of high credit quality are available to invest the Commissioners cash balances, then the surplus will be deposited with the UK Government, via the Debt Management Office or invested in government treasury bills for example, or with other local authorities. This will cause a reduction in the level of investment income earned, but will protect the principal sum invested.

8.11 Specified Investments:

The CLG Guidance defines specified investments as those:

- denominated in pound sterling;
- due to be repaid within 12 months of arrangement;
- not defined as capital expenditure by legislation; and
- invested with one of:
    - the UK Government
    - a UK local authority, parish council or community council, or
    - a body or investment scheme of “high credit quality” (as per approved counter party limits).

8.12 Non-specified Investments

Any investment not meeting the definition of a specified investment is classed as non-specified. The Commissioners do not intend to make any investments denominated in foreign currencies, nor any that are defined as capital expenditure by legislation, such as company shares. Non-specified investments will therefore be limited to long-term investments those that are due to mature 12 months or longer from the date of arrangement , and investments with bodies and schemes not meeting the definition on high credit quality. The Commissioners will now set separate limits for Warwickshire and West Mercia. Limits on non-specified investments are shown in the table below.

	Warwickshire Cash Limit	**West Mercia Cash Limit**
Total long-term investments	£5m	£10m
Total investments without credit ratings or rated below A-(except UK Government and local authorities)	£5m	£10m
Total investments with institutions domiciled in foreign countries rated below AA+	£0m	£0m
Total non specified investments	£10m	£20m

9. Investment Limits –

9.1 The Commissioner for Warwickshire's revenue reserves available to cover investment losses are £16.7m on 31st March 2018. Given the cash flow profile and the level of reserves the maximum that will be lent to any one organisation other than the UK government will be £2m

The Commissioner for West Mercia's revenue reserves available to cover investment losses are £34.9m on 31st March 2018. Given the cash flow profile and the level of reserves the maximum that will be lent to any one organisation other than the UK government will be £3m

Counter party limits will be kept under review during the year as the investment balances change. The counter party limits in this report reflect the maximum investment

9.2 A group of banks under the same ownership will be treated as a single organisation for limit purposes.

9.3 Limits will also be placed on fund managers and investments in industry sectors as below:

	Warwickshire Cash Limit	**West Mercia Cash Limit**
Any single organisation, except the UK Central Government and Local Authorities	£2m	£3m
UK Central Government	Unlimited	Unlimited
UK Local Organisations	£3m	£5m
Any group of organisations under the same ownership	£3m per group	£5m per group
Registered Providers (Housing Associations)	£4m	£8m
Unsecured Investments with Building Societies	£4m	£8m
Money Market Funds	£6m	£12m
Foreign Countries	£2m	£4m

9.4 Liquidity Management

The Commissioners are continually developing their cash flow management and forecasting arrangements to determine the maximum period for which funds may prudently be committed. Current forecasts are compiled on a prudent basis to minimise the risk of the Commissioners being forced to borrow on unfavourable terms to meet their financial commitments. Limits on long-term investments are set by reference to the Commissioners' medium term financial plan and cash flow forecast.

10 Treasury Management Indicators

The Commissioners measure and manage their exposure to treasury management risks using Treasury Management indicators governing upper limits for fixed and variable rate exposure. Having reviewed best practice, it is proposed that the following further indicators be piloted on a trial basis.

Security

The Commissioners will pilot a voluntary measure of their exposure to credit risk by monitoring the value weighted average credit rating / credit score of their investment portfolios.

	Target
Portfolio average credit rating for Warwickshire	A-
Portfolio average credit rating for West Mercia	A-

Liquidity

The Commissioners will continue to adopt a voluntary measure of their exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments within a rolling three month period without additional borrowing.

	Target
Total Cash Available for 3 months for Warwickshire	£21.7m
Total Cash Available for 3 months for West Mercia	£29.9m

Interest Rate Exposures

This indicator is set to control the Commissioners exposure to interest rate risk. The upper limits on fixed and variable rate interest rate exposures, expressed as the amount / the proportion of net principal borrowed / interest payable will be:

Warwickshire	**2018/19**	**2019/20**	**2020/21**
Upper limit on fixed interest rate	£29.0m	£31.3m	£34.6m

exposure*			
Upper limit on variable interest rate exposure	£3m	£3m	£3m

West Mercia	2018/19	2019/20	2020/21
Upper limit on fixed interest rate exposure*	£46.5m	£54.2m	£67.1m
Upper limit on variable interest rate exposure	£5m	£5m	£5m

* this is the CFR figure.

Maturity Structure of Borrowing

This indicator is set to control the Commissioners exposure to refinancing risk. The upper and lower limits on the maturity of fixed rate borrowing will be:

	Upper	Lower
Under 12 Months	50%	50%
12 Months and within 24 Months	100%	100%
24 Months and within 5 Years	100%	100%
5 Years and within 10 Years	100%	100%
10 Years and above Use additional periods above 10 years if there is a large amount of debt in this period	100%	100%

Time periods start on the first day or each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment.

Principal Sums Invested for Periods Longer than 364 days

The purpose of this indicator is to control the Commissioners exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the long-term principal sum invested to final maturities beyond the period end will be:

Warwickshire	2018/19	2018/19	2019/20
Limit on principal invested beyond year end	£3m	£3m	£3m

West Mercia	2018/19	2018/19	2019/20
Limit on principal invested beyond year end	£8m	£8m	£8m

11 Other Items

There are a number of additional items that the Commissioner(s) are obliged by CIPFA or CLG to include in its Treasury Management Strategy.

11.1 Policy on Use of Financial Derivatives:

In the absence of any explicit legal power to do so, the Commissioners will not use standalone financial derivatives (such as swaps, forwards, futures and options). Derivates embedded into loans and investments, including pooled funds and forward starting transactions, may be used, and the risks that they present will be managed in live with the overall treasury risk management strategy.

Commissioners can make use of financial derivatives embedded into loans and investments both to reduce interest rate risk (e.g. interest rate collars and forward deals) and to reduce costs or increase income at the expense of greater risk (e.g. LOBO loans and callable deposits). The general power of competence in Section 1 of the *Localism Act 2011* removes much of the uncertainty over local authorities' use of standalone financial derivatives (i.e. those that are not embedded into a loan or investment).

11.2 Investment Training and Advisors

The needs of the Commissioners treasury management staff for training in investment management are assessed annually as part of the staff appraisal process, and additionally when the responsibilities of individual members of staff change. Staff regularly attend training courses, seminars and conferences provided by Arlingclose and CIPFA. Relevant staff are also encouraged to study professional qualifications from CIPFA, the Association of Corporate Treasurers and other appropriate organisations.

The Commissioners have appointed Arlingclose Limited as treasury management advisers and receives specific advice on investment, debt and capital finance issues.

11.3 Investment of Money Borrowed in Advance of Need

The Commissioner may, from time to time, borrow in advance of need, where this is expected to provide the best long term value for money. Since amounts borrowed will be invested until spent, the Commissioners are aware that it will be exposed to the risk of loss of the borrowed sums, and the risk that investment and borrowing interest rates may change in the intervening period. These risks will be managed as part of the Commissioners' overall management of its treasury risks.

The total amount borrowed will not exceed the authorised borrowing limit of £40m for Warwickshire and £60m for West Mercia. The maximum period between borrowing and expenditure is expected to be two years, although the Commissioners are not required to link particular loans with particular items of expenditure.

12 Financial Implications

12.1 Warwickshire

The budget for investment income in 2018/19 is £23k, based on an average investment portfolio of £6 million at an interest rate of 0.40%. The budget for debt interest payable in 2018/19 is £0.645m, based on an average debt portfolio of £13.5m at an average interest rate of 4.8%. These figures assume no revenue underspends in 2017/18 and no new borrowing being undertaken during 2018/19. If actual levels of investments and borrowing, and actual interest rates differ from those forecast, performance against budget will be correspondingly different.

12.2 West Mercia

The budget for investment income in 2018/19 is £59k, based on an average investment portfolio of £15 million at an interest rate of 0.40%. The budget for debt interest payable in 2018/19 is £0.850m, based on an average debt portfolio of £25.0m at an average interest rate of 3.4%. These figures assume no revenue underspends in 2017/18 and new borrowing of £15m occurring at the start of 2018/19. If actual levels of investments and borrowing, and actual interest rates differ from those forecast, performance against budget will be correspondingly different.

13 Other Options Considered

The CLG Guidance and the CIPFA Code do not prescribe any particular treasury management strategy for local authorities to adopt. The Treasurer having consulted the Joint Audit Committee believes that the above strategy represents an appropriate balance between risk management and cost effectiveness. Some alternative strategies, with their financial and risk management implications, are listed below:

Alternative	Impact on Income and Expenditure	Impact on Risk Management
Invest in a narrower range of counterparties and / or for shorter times.	Interest income will be lower.	Lower chance of losses from credit related defaults, but any such losses may be greater.
Invest in a wider range of counterparties and / or for longer times.	Interest income will be higher.	Increased risk of losses from credit related defaults, but any such losses may be smaller.
Borrow additional sums at long-term fixed interest rates.	Debt interest costs will rise; this is unlikely to be offset by higher investment	Higher investment balance leading to a higher impact in the event

	income.	of a default, however long-term interest costs may be more certain.
Borrow short-term or variable loans instead of long-term fixed rates.	Debt interest costs will initially be lower.	Increases in debt interest costs will be broadly offset by rising investment income in the medium term, but long term costs may be less certain.
Reduce level of borrowing	Saving on debt interest is likely to exceed lost investment income.	Reduced investment balance leading to a lower impact in the event of a default; however long-term interest costs may be less certain.

14 Review of Minimum Revenue Provision

Minimum Revenue Provision (MRP) is the method by which local authorities and PCCs charge their revenue accounts over time with the cost of their capital expenditure that was originally funded by debt. In effect, it covers the cost of the principal repayments on the debt and ensures that this is spread evenly over the life of the assets rather than when it is actually repaid (often at the end of the life of the loan).

A revised MRP policy was presented to the Joint Audit Committee and approved by the Commissioners in January 2018. This police harmonises the Warwickshire and West Mercia MRP policies and was effective from 1 April 2017. Appendix A takes account of the revised policy.

APPENDIX A

POLICE AND CRIME COMMISSIONER FOR WARWICKSHIRE

Prudential Indicators and MRP Statement 2018/19

Prudential Indicators 2018/19

The Local Government Act 2003 requires the Authority to have regard to the Chartered Institute of Public Finance and Accountancy's *Prudential Code for Capital Finance in Local Authorities* (the Prudential Code) when determining how much money it can afford to borrow. The objectives of the Prudential Code are to ensure, within a clear framework, that the capital investment plans of Police and Crime Commissioners (PCCs) are affordable, prudent and sustainable, and that treasury management decisions are taken in accordance with good professional practice. To demonstrate that the PCC has fulfilled these objectives, the Prudential Code sets out the following indicators that must be set and monitored each year.

Estimates of Capital Expenditure: The PCC's planned capital expenditure and financing may be summarised as follows:

Capital Expenditure and Financing	2017/18 Latest Forecast £m	2018/19 Estimate £m	2018/19 Estimate £m	2019/20 Estimate £m
Total Expenditure	**9.808**	**7.912**	**8.266**	**6.898**
Capital Receipts	0.286	2.500	2.500	2.000
Government Grants	0.425	0.425	0.425	0.425
Reserves	2.094	2.000	2.000	0.000
Revenue	0.121	0.000	0.000	0.000
Borrowing	6.882	2.987	3.341	4.473
Total Financing	**9.808**	**7.912**	**8.266**	**6.898**

Estimates of Capital Financing Requirement: The Capital Financing Requirement (CFR) measures the PCC's underlying need to borrow for a capital purpose.

Capital Financing Requirement	31.03.18 Revised £m	31.03.19 Estimate £m	31.03.20 Estimate £m	31.03.21 Estimate £m
Total CFR	**25.884**	**28.993**	**31.321**	**34.616**

The CFR is forecast to rise by nearly £9m over the next three years as capital expenditure financed by debt outweighs resources put aside for debt repayment.

Gross Debt and the CFR: In order to ensure that over the medium term debt will only be for a capital purpose, the PCC should ensure that debt does not, except in the short term, exceed the total of CFR in the preceding year plus the estimates of any additional CFR for the current and next two financial years. This is a key indicator of prudence.

Debt	31.03.18 Revised £m	31.03.19 Estimate £m	31.03.20 Estimate £m	31.03.21 Estimate £m
Total Borrowing	**14.030**	**17.063**	**19.444**	**22.935**

Total debt is expected to remain below the CFR during the forecast period.

Operational Boundary for External Debt: The operational boundary is based on the PCC's estimate of most likely (i.e. prudent but not worst case) scenario for external debt. It links directly to the PCC's estimates of capital expenditure, the CFR and cash flow requirements, and is a key management tool for in-year monitoring.

Operational Boundary	2017/18 Revised £m	2018/19 Estimate £m	2019/20 Estimate £m	2020/21 Estimate £m
Total Debt	**30.000**	**30.000**	**35.000**	**35.000**

Authorised Limit for External Debt: The authorised limit is the affordable borrowing limit determined in compliance with the Local Government Act 2003. It is the maximum amount of debt that the PCC can legally owe. The authorised limit provides headroom over and above the operational boundary for unusual cash movements.

Authorised Limit	2017/18 Revised £m	2018/19 Estimate £m	2019/20 Estimate £m	2020/21 Estimate £m
Total Debt	**40.000**	**40.000**	**45.000**	**45.000**

Ratio of Financing Costs to Net Revenue Stream: This is an indicator of affordability and highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet financing costs, net of investment income.

Ratio of Financing Costs to Net Revenue Stream	2017/18 Revised %	2018/19 Estimate %	2019/20 Estimate %	2020/21 Estimate %
General Fund	1.24	1.62	1.80	2.01

Incremental Impact of Capital Investment Decisions: This is an indicator of affordability that shows the impact of capital investment decisions on Council Tax levels. The incremental impact is the difference between the total revenue budget requirement of the current approved capital programme and the revenue budget requirement arising from the capital programme proposed

Incremental Impact of Capital Investment Decisions	2018/19 Estimate £	2019/20 Estimate £	2020/21 Estimate £
General Fund - increase in annual band D Council Tax	0.59	0.41	0.47

Annual Minimum Revenue Provision Statement 2018/19

Where the PCC finances capital expenditure by debt, he must put aside resources to repay that debt in later years. The amount charged to the revenue budget for the repayment of debt is known as Minimum Revenue Provision (MRP), although there has been no statutory minimum since 2008. The Local Government Act 2003 requires the PCC to have regard to the Department for Communities and Local Government's *Guidance on Minimum Revenue Provision* (the CLG Guidance) most recently issued in 2012.

The broad aim of the CLG Guidance is to ensure that debt is repaid over a period that is either reasonably commensurate with that over which the capital expenditure provides benefits, or, in the case of borrowing supported by Government Revenue Support Grant, reasonably commensurate with the period implicit in the determination of that grant.

The CLG Guidance requires the PCC to approve an Annual MRP Statement each year, and recommends a number of options for calculating a prudent amount of MRP. The following statement incorporates options recommended in the Guidance:

> For capital expenditure incurred before 1st April 2008, MRP will be determined in accordance with the former regulations that applied on 31st March 2008. MRP has been calculated on a straight-line basis over a 40 year period.
>
> For unsupported capital expenditure incurred after 31st March 2008, MRP will be determined by charging the expenditure over the period over which the capital expenditure provides a benefit to the PCC (based on the expected useful life of the relevant asset) using the annuity method, starting in the year after the asset becomes operational.

Capital expenditure incurred during 2018/19 will not be subject to a MRP charge until 2019/20.

Based on the PCC's estimate of its Capital Financing Requirement on 31st March 2018 at the time of setting the budget, the budget for MRP has been set as follows:

	31.03.2018 Estimated CFR £m	**2018/19 Estimated MRP £m**
Capital expenditure before 01.04.2008	11.430	0.286
Unsupported capital expenditure after 31.03.2008	15.437	0.540
Total General Fund	**26.867**	**0.826**

APPENDIX B

POLICE AND CRIME COMMISSIONER FOR WEST MERCIA

Prudential Indicators and MRP Statement 2018/19

Prudential Indicators 2018/19

The Local Government Act 2003 requires the Authority to have regard to the Chartered Institute of Public Finance and Accountancy's *Prudential Code for Capital Finance in Local Authorities* (the Prudential Code) when determining how much money it can afford to borrow. The objectives of the Prudential Code are to ensure, within a clear framework, that the capital investment plans of Police and Crime Commissioners (PCCs) are affordable, prudent and sustainable, and that treasury management decisions are taken in accordance with good professional practice. To demonstrate that the PCC has fulfilled these objectives, the Prudential Code sets out the following indicators that must be set and monitored each year.

Estimates of Capital Expenditure: The PCC's planned capital expenditure and financing may be summarised as follows:

Capital Expenditure and Financing	2017/18 Latest Forecast £m	2018/19 Estimate £m	2019/20 Estimate £m	2020/21 Estimate £m
Total Expenditure	**22.233**	**14.461**	**17.365**	**16.651**
Capital Receipts	0.747	2.047	1.049	1.051
Government Grants	0.730	0.730	0.730	0.730
Reserves	7.590	6.000	6.000	0.000
Revenue	0.419	0.000	0.000	0.000
Borrowing	12.747	5.684	9.586	14.870
Total Financing	**22.233**	**14.461**	**17.365**	**16.651**

Estimates of Capital Financing Requirement: The Capital Financing Requirement (CFR) measures the Commissioners underlying need to borrow for a capital purpose.

Capital Financing Requirement	31.03.18 Revised £m	31.03.19 Estimate £m	31.03.20 Estimate £m	31.03.21 Estimate £m
Total CFR	**40.523**	**46.452**	**54.215**	**67.058**

The CFR is forecast to rise by nearly £27m over the next three years as capital expenditure financed by debt outweighs resources put aside for debt repayment.

Gross Debt and the CFR: In order to ensure that over the medium term debt will only be for a capital purpose, the PCC should ensure that debt does not, except in the short term, exceed the total of CFR in the preceding year plus the estimates of any additional CFR for the current and next two financial years. This is a key indicator of prudence.

Debt	31.03.18 Revised £m	31.03.19 Estimate £m	31.03.20 Estimate £m	31.03.21 Estimate £m
Total Borrowing	**13.000**	**20.411**	**29.997**	**44.866**

Total debt is expected to remain below the CFR during the forecast period.

Operational Boundary for External Debt: The operational boundary is based on the PCC's estimate of most likely (i.e. prudent but not worst case) scenario for external debt. It links directly to the PCC's estimates of capital expenditure, the CFR and cash flow requirements, and is a key management tool for in-year monitoring.

Operational Boundary	2017/18 Revised £m	2018/19 Estimate £m	2019/20 Estimate £m	2020/21 Estimate £m
Total Debt	**50.000**	**50.000**	**55.000**	**70.000**

Authorised Limit for External Debt: The authorised limit is the affordable borrowing limit determined in compliance with the Local Government Act 2003. It is the maximum amount of debt that the Commissioners can legally owe. The authorised limit provides headroom over and above the operational boundary for unusual cash movements.

Authorised Limit	2017/18 Revised £m	2018/19 Estimate £m	2019/20 Estimate £m	2020/21 Estimate £m
Total Debt	**60.000**	**60.000**	**65.000**	**80.000**

Ratio of Financing Costs to Net Revenue Stream: This is an indicator of affordability and highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet financing costs, net of investment income.

Ratio of Financing Costs to Net Revenue Stream	2017/18 Revised %	2018/19 Estimate %	2019/20 Estimate %	2020/21 Estimate %
General Fund	0.82	1.17	1.23	1.45

Incremental Impact of Capital Investment Decisions: This is an indicator of affordability that shows the impact of capital investment decisions on Council Tax levels. The incremental impact is the difference between the total revenue budget requirement of the current approved capital programme and the revenue budget requirement arising from the capital programme proposed.

Incremental Impact of Capital Investment Decisions	**2018/19 Estimate £**	**2019/20 Estimate £**	**2020/21 Estimate £**
General Fund - increase in annual band D Council Tax	0.63	0.16	0.48

Adoption of the CIPFA Treasury Management Code: The Authority adopted the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice 2011 Edition*. It fully complies with the Codes recommendations.

Annual Minimum Revenue Provision Statement 2018/19

Where the PCC finances capital expenditure by debt, he must put aside resources to repay that debt in later years. The amount charged to the revenue budget for the repayment of debt is known as Minimum Revenue Provision (MRP), although there has been no statutory minimum since 2008. The Local Government Act 2003 requires the PCC to have regard to the Department for Communities and Local Government's *Guidance on Minimum Revenue Provision* (the CLG Guidance) most recently issued in 2012.

The broad aim of the CLG Guidance is to ensure that debt is repaid over a period that is either reasonably commensurate with that over which the capital expenditure provides benefits, or, in the case of borrowing supported by Government Revenue Support Grant, reasonably commensurate with the period implicit in the determination of that grant.

The CLG Guidance requires the PCC to approve an Annual MRP Statement each year, and recommends a number of options for calculating a prudent amount of MRP. The following statement incorporates options recommended in the Guidance:

> For capital expenditure incurred before 1st April 2008, MRP will be determined in accordance with the former regulations that applied on 31st March 2008. MRP has been calculated on a straight-line basis over a 40 year period.
>
> For unsupported capital expenditure incurred after 31st March 2008, MRP will be determined by charging the expenditure over the period over which the capital expenditure provides a benefit to the PCC (based on the expected useful life of the relevant asset) using the annuity method, starting in the year after the asset becomes operational.

Capital expenditure incurred during 2018/19 will not be subject to a MRP charge until 2019/20.

Based on the PCC's estimate of its Capital Financing Requirement on 31st March 2018 at the time of setting the budget, the budget for MRP has been set as follows:

	31.03.2018 Estimated CFR £m	**2018/19 Estimated MRP £m**
Capital expenditure before 01.04.2008	0.281	0.011
Unsupported capital expenditure after 31.03.2008	41.885	1.368
Total	**42.166**	**1.379**

APPENDIX C

The Treasury Management Role of the S151 (Responsible) Officer

- Recommending clauses, treasury management policy / practices for approval, reviewing the same regularly, and monitoring compliance.
- Reviewing the list of approved counterparties in accordance with recommendations from appointed treasury advisers (currently Arlingclose).
- 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.

APPENDIX D

1. What is a Minimum Revenue Provision?

Capital expenditure is generally expenditure on assets, which have a life expectancy of more than one year, e.g., buildings, vehicles, machinery, etc. It would be impractical to charge the entirely of such expenditure to revenue in the year in which it was incurred and such expenditure is spread over several years so as to try to match the years over which such assets benefit the local community through their useful life. The manner of spreading these costs is through an annual Minimum Revenue Provision (MRP).

2. Statutory Duty

Statutory Instrument 2008 no.414 s4 lays down that:

"A local authority shall determine for the current financial year an amount of minimum revenue provision that it considers to be prudent".

There is no requirement to charge MRP where the Capital Financing Requirements is nil or negative at the end of the preceding financial year.

3. Government Guidance

Along with the above duty, the Government issued guidance in February 2008 and updated in 2012. This requires that a Statement on the Commissioner's policy for its annual MRP should be agreed before the start of the financial year to which the provision will relate and permits the Commissioner to vary the terms of the original MRP Statement in year, with a revised Statement being approved at that time.

The Commissioner is legally obliged to "have regard" to the guidance, which is intended to enable a more flexible approach to assessing the amount of annual provision that was required under the previous statutory requirements. The guidance offers four main options under which MRP could be made with an overriding recommendation that the Commissioner should make prudent provision to redeem its debt liability over a period which is reasonably commensurate with that over which the capital expenditure is estimated to provide benefits. The requirement to "have regard" to the guidance therefore means that:

a. Although four main options are recommended in the guidance, there is no intention to be prescriptive by making these the only methods of charge under which the Commissioner may consider his MRP to be prudent.

b. It is the responsibility of each Commissioner to decide upon the most appropriate method of making a prudent provision, after having had regard to the guidance.