Joint Audit and Standards Committee

17 March 2020

Warwickshire Police Crime Commissioner
Treasury Management Strategy 2020/2021

Report of the Treasurer

Recommendations

That:

The Joint Audit and Standards Committee support the following recommendations**:**

a) the Treasury Management Strategy and Investment Strategy for 202021 be approved by the Police and Crime Commissioner for Warwickshire;

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

c) the Commissioner requires 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 Commissioner has delegated 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 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 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 Treasury risk management at the Force is conducted within the framework of the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice 2017 Edition* (the CIPFA Code) which requires the Force to approve a treasury management strategy before the start of each financial year. This report fulfils the Authority's legal obligation under the *Local Government Act 2003* to have regard to the CIPFA Code.

1.5 The 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.

1.6 The Commissioner is 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

1.7 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.

1.8 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 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 Commissioner of the role of scrutiny of treasury management strategy and policies to a specific named body. In this respect the Commissioner has chosen to delegate this responsibility to the Joint Audit Committee

1.8 The suggested strategy for 2020/21 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 (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 2020/21 to 2023/24
- Prudential indicators
- External and local content
- Borrowing strategy
- Debt rescheduling
- Investment strategy
- Minimum Revenue Provision (MRP) strategy

1.10 In accordance with the CIPFA Code the Commissioner 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 Commissioner's capital programme or in the level of its investment balance.

2 Treasury Limits for 2020/21 to 2023/24

2.1 The 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 Commissioner 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 portfolio are as follows:

Treasury Portfolio at 31st January 2020	Principal £m	Average Rate %
Fixed Rate Funding Public Works Loans Board	 12.13	 4.66
Investments In House Externally Managed	 12.0 0.0	 0.65 0.00
Net Debt	(0.13)	

2.5 The Commissioner's borrowing requirements are as follows:

Borrowing Requirement	18/19 Actual £m	19/20 Estimate £m	20/21 Estimate £m	21/22 Estimate £m	22/23 Estimate £m	23/24 Estimate £m
New borrowing*	0.0	2.36	11.38	6.0	4.4	1.9
Replacement borrowing	0.0	0.0	0.0	0.0	0.0	0.0
Total	**0.0**	**2.36**	**11.38**	**6.0**	**4.4**	**1.9**

3 Prudential Indicators for 2020/21 to 2023/24

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 UK's progress negotiating its exit from the European Union, together with its future trading arrangements, will continue to be a major influence on the Authority's treasury management strategy for 2020/21. More immediately, the effect of the coronavirus epidemic has depressed economic activity in some countries, particularly China, and is likely to have damaging repercussions for the global economy.

Since first appearing in China in December 2019, the coronavirus has now spread to around 40 countries and caused sharp falls in financial markets as part of a flight to quality into sovereign debt and other perceived 'safe' assets. The longer-term impact of the virus on global growth remains uncertain at the moment but as the number of cases and affected countries grows, the impact increases in severity, particularly given the importance of China in global trade. The Federal Reserve cut the Fed Funds policy rate by 0.50% to 1.0 – 1.25%, in order to restore investor confidence and cushion the impact of the virus on activity. Other central banks have followed suit, but this has not stopped a severe reaction in financial markets as investors project a sharp slowdown in global growth.

The UK economy flatlined in Q4 2019 as the political uncertainties surrounding the General Election and Brexit weighed on business and household sentiment. UK GDP growth was flat in the fourth quarter of 2019, according to the initial estimate from the Office for National Statistics, down from an upwardly revised 0.5% in Q3. A recovery in various economic indicators in Q1 2020 suggested the resumption of confidence following the Election result , but expectations of a reduction in Bank Rate are high due to the impact of coronavirus.

Credit outlook: Credit Default Swap spreads have remained broadly flat since the start of 2020 and trading in a slightly tighter range compared to the last calendar quarter of 2019. Spreads have risen due to the onset of coronavirus, but remain low historically.

There were only a few credit updates over the period. Standard & Poor's revised the outlook on Clydesdale Bank to positive (and affirmed the long-term and short-term ratings) to reflect its view that as part of the Virgin Money group it has made good progress increasing its capital buffer and bail-in eligible liabilities. Moody's upgraded the long-term ratings of Barclays Bank Plc (non-ringfenced) to A1 and changed the outlook to stable, reflecting an improved operating performance and profitability prospects of the parent, Barclays Plc, which itself was updated to Baa2.

Interest rate outlook: The global economic outlook has rapidly deteriorated with the escalation and spread of coronavirus (COVID-19) to all regions and concerns over its scale and longevity. The economic shock is affecting both supply and demand sides of economies through disruption to trade; containment efforts by governments, corporates and individuals and the damage to sentiment could halve global growth from 2.9% to 1.5% in 2020 (OECD), with a worse-case scenario of a sharper contraction and global recession.

Central banks have already responded in the US, Canada and Australia with interest rate cuts. Outgoing Bank of England Governor has commented the Bank's response will be "powerful and timely" and Arlingclose expects the

MPC to deliver two 0.25% reductions in quick succession, the first imminently at an emergency meeting this month.

The government will outline its public spending intentions in the March Budget and undertake substantial fiscal loosening in 2020/21. The Chancellor is now also expected to announce a package of measures to ease COVID-19's pressure on the health service, consumers and businesses. Nevertheless, activity will also hinge on COVID-19's global economic damage and outcome.

Chinese activity remains impaired despite a slowdown in cases. As one of the main drivers of global economic growth and its integral position in many global supply chains, a persistent downturn in its economy is having a global spill-over and wide-ranging ramifications. The UK economy is likely to face issues with supply, due to the global impact on supply chains, and demand, as individuals travel less frequently for both work and leisure. Economic growth will therefore be weak for H1 2020. Prior to the virus, the more stable political environment had prompted a partial return in business and household confidence, and a bounce in economic activity and inflation. Whether this can be maintained or at least returned to during this year depends on the extent and duration of the virus impact.

4.1 Financial Markets

Financial markets adopted a more risk-on approach over the quarter as equities rallied in expectation of ongoing monetary stimulus from central banks. The Dow Jones ended the 2019 calendar year up 22%, while the FTSE 100 and FTSE 250 jumped on the UK general election result with the former gaining 12% during 2019 and the latter around 25%.

Gilt yields remained volatile over the period. From 0.28% at the end of September, the 5-year benchmark gilt rose to 0.60% by the end of December. There were rises in the 10-year and 20-year gilts over the same period, with the former climbing from 0.48% to 0.82% and the latter from 0.88% to 1.24%. 1-month, 3-month and 12-month SONIA (Sterling Overnight Index Average) bid rates averaged 0.63%, 0.76% and 0.93% respectively over the period.

The US yield curve returned to 'normal' over the period with 2-year ending 2019 at 1.56% and the 10-year at 1.91%. German bunds continued to remain firmly negative with the 10-year ending 2019 at -0.19% with 2 and 5-year securities ending at -0.61% and -0.46% respectively.

4.2 Credit background:

Credit Default Swap (CDS) spreads fell over the quarter. Non-ringfenced bank NatWest Markets plc CDS fell to 50 basis points at the end of December from over 80bp in September, while for the ringfenced entity, National Westminster Bank plc, the spread fell to around 30bp. The other main UK banks, as yet not separated into ringfenced and non-ringfenced from a CDS perspective, traded between 29 and 50bp at the end of the quarter.

Fitch affirmed the UK's AA sovereign rating, removed it from Rating Watch Negative (RWN) and assigned a negative outlook. Fitch then affirmed UK banks' long-term ratings, removed the RWN and assigned a stable outlook. Standard & Poor's also affirmed the UK sovereign AA rating and revised the outlook to stable from negative.

Moody's revised HSBC Bank's outlook to negative from stable as it expects restructuring costs to negatively impact net income over the next year or two.

The Bank of England announced its latest stress tests results for the main seven UK banking groups. All seven passed on both a common equity Tier 1 (CET1) ratio and a leverage ratio basis. Under the test scenario the banks' aggregate level of CET1 capital would remain twice their level before the 2008 financial crisis.

5 Local Context

On 31st March 2019, the Authority had net investments of £10.3m arising from its revenue and capital income and expenditure. 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. These factors are summarised in Table 1 below.

Table 1: Balance Sheet Summary

	31.3.19 Actual £m	**31.3.20 Estimate £m**	**31.3.21 Estimate £m**	**31.3.22 Estimate £m**	**31.3.23 Estimate £m**
Borrowing CFR	24.8	30.3	44.7	46.6	46.4
Less External borrowing	13.1	14.5	24.9	29.9	33.3
Internal (over) borrowing	**11.7**	**15.8**	**19.8**	**16.7**	**13.1**

Less: Usable reserves	(17.7)	(13.4)	(8.4)	(8.1)	(8.1)
Less: Working capital	(4.3)	(5.0)	(1.0)	(0.9)	(0.9)
Net (Investments) / borrowing	**(10.3)**	**(2.6)**	**10.4**	**7.7**	**4.1**

6 Borrowing Strategy

6.1 On 9th October 2019 the PWLB raised the cost of certainty rate borrowing by 1% to 1.8% above UK gilt yields as HM Treasury was concerned about the overall level of local authority debt. PWLB borrowing remains available but the margin of 180bp above gilt yields appears relatively very expensive. Market alternatives are currently available and new products will be developed; however, the financial strength of individual authorities will be scrutinised by investors and commercial lenders.

Short-term "local to local" funding is available at around Bank Rate of 0.75% and 1-year money around 1.1%.

At 31st December 2019 the Authority held £12.13m of loans, (a decrease of £1.4m from 31st March 2019, but £0.5m of this related to March 2019 repayment taken 1st April by bank) as part of its strategy for funding previous years' capital programmes.

6.2 The Authority's chief objective when borrowing has been to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required, with flexibility to renegotiate loans should the Authority's long-term plans change being a secondary objective.

6.3 The Authority's borrowing decisions are not predicated on any one outcome for interest rates and a balanced portfolio of short- and long-term borrowing was maintained.

6.4 Given the significant cuts to public expenditure, the 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 lower than long-term rates, it could be more cost effective to borrow short-term loans. By doing so, the 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.

Arling close will assist the 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 2020/21 with a view to keeping future interest costs low, even if this causes additional cost in the short-term

.
The Commissioner has previously raised all of its long-term borrowing from the PWLB but the government increased PWLB rates by 1% in October 2019 making it now a relatively expensive options. The Commissioner will now look to borrow any long-term loans from other sources including banks, pensions and local authorities, in order to lower interest costs and reduce over-reliance on one source of funding in line with the CIPFA Code.

Alternatively, the Commissioner may arrange forward starting loans during 2020/21, 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 Commissioner 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
- any other UK public sector body
- UK public and private sector pension funds (except Warwickshire County Council and Warwickshire County Council Pension Fund)

Other sources of debt finance:
In addition, capital finance may be raised by the following methods that are not borrowing, but may be classed as other debt liabilities:

Leasing
Hire Purchase
Sale and Leaseback

The Commissioner has previously raised all of his long-term borrowing from the PWLB but continues to investigate other sources of finance, such as local authority loans and bank loans that may be available at more favourable rates.

Municipal Bonds Agency:
UK Municipal Bonds Agency plc was established in 2014 by the Local Government Association as an alternative to the PWLB. It plans to issue bonds on the capital markets and lend the proceeds to local authorities. This will be a more complicated source of finance than the PWLB for two reasons: borrowing authorities will be required to provide bond investors with a guarantee to refund their investment in the event that the agency is unable to for any reason; and there will be a lead time of several months between committing to borrow and knowing the interest rate payable. Any decision to

borrow from the Agency will therefore be the subject of a separate report to the PCC.

6.5 In view of the above forecast, the Commissioner's 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 to maintain a balanced spread of maturities.

In addition, it is important to note that Commissioner will seek to minimise his future borrowings by using revenue budget under spends to defray borrowing where this is feasible and prudent.

6.6 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 Finance 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.

6.7 Policy on borrowing in advance of need

The Commissioner will not borrow more than or in advance of his needs purely in order to 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 Commissioner can ensure the security of such funds.

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

- Ensure that there is a clear link between the capital programme and maturity profile 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 The PWLB allows authorities to repay loans before maturity and either pay a premium or receive a discount according to a set formula based on current interest rates. Other lenders may also be prepared to negotiate premature redemption terms. The Commissioner may take advantage of this and replace some loans with new loans, or repay loans without replacement, where this is expected to lead to an overall cost saving or a reduction in risk.

7.2 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)

7.3 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. Investment Strategy

Investment Policy

8.1 The Commissioner will have regard to the DCLG's Guidance on Local Government Investments ("the Guidance") and the 2017 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 the Commissioner to invest his funds prudently, and to have regard to the security and liquidity of their investments before seeking the highest rate of return, or yield. The Commissioner's objective 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 Commissioner's investment priorities are the security of capital and the liquidity of investments.

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

8.4 In accordance with the above, and in order to minimise the risk to investments, the Commissioner has stipulated below 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 Negative interest rates: If the UK enters into a recession in 2020/21, there is a small chance that the Bank of England could set its Bank Rate at or below zero, which is likely to feed through to negative interest rates on all low risk, short-term investment options. This situation already exists in many other European countries. In this event, security will be measured as receiving the contractually agreed amount at maturity, even though this may be less than the amount originally invested.

8.8 The Commissioner may invest its surplus funds with any of the counterparty types in Table 2 below, subject to the cash limits (per counterparty) and the time limits shown.

Table 8.8 Approved Investment Counterparts and Limits.

<u>Approved Counterparty Limits</u>

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-	£2m 3 Years	£1.5m 3 Years	£2m 3 Years
A+	£2m 2 Years	£1.5m 2 Years	£2m 2 Years
A	£2m 13 Months	£1.5m 2 Years	£2m 2 Years
A-	£2m 6 Months	£1.5m 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	£1.5m 3 Years	N/A
Money Market Funds	£2M Per Fund		
Current Account Bank (Lloyds) if the credit rating is A- or above	£10m 6 Months	N/A	N/A
Current Account Bank (Lloyds) if it fails to meet the above criteria	£1m Next Working Day	N/A	N/A

This table must be read in conjunction with the notes below.

a) Credit rating: Investment limits are set by reference to the lowest published long-term credit rating from a selection of external rating agencies. Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating 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) Banks unsecured: 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. See below for arrangements relating to operational bank accounts.

c) Banks secured: Covered bonds, reverse repurchase agreements and other collateralised 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) Government: 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 generally a lower risk of insolvency, although they are not zero risk. Investments with the UK Central Government may be made in unlimited amounts for up to 50 years.

f) Registered providers: Loans and bonds issued by, guaranteed by or secured on the assets of registered providers of social housing and registered social landlords, formerly known as housing associations. These bodies are tightly regulated by the Regulator of Social Housing (in England), the Scottish Housing Regulator, the Welsh Government and the Department for Communities (in Northern Ireland). As providers of public services, they retain the likelihood of receiving government support if needed.

g) Bond, equity and property funds offer enhanced returns over the longer term, but are more volatile in the short term. These allow the Commissioner's 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 £5m 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 £2.0m invested funds as at 31 March 2020, representing income received in advance of expenditure plus balances and reserves held. In the past 12 months, Warwickshire's investment balance ranged between £4.0 and £25.0 million, and similar levels are expected to be maintained in the forthcoming year.

8.10 Risk Assessment and Credit Ratings:

Credit ratings are obtained and monitored by the Commissioner's 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.

Other information on the security of investments: The Commissioner understands that credit ratings are good, but not perfect, predictors of investment default. 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, reports in the quality financial press and analysis and advice from the Commissioner's treasury management adviser. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may otherwise meet the above 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 ratings, but can be seen in other market measures. In these circumstances, the Commissioner 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. If these restrictions mean that 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.

9. Investment Limits

9.1 The Commissioner for Warwickshire’s revenue reserves available to cover investment losses are estimated to be £13.4m on 31st March 2020. In order that no more than 10% of available reserves will be put at risk in the case of a single default the maximum that will be lent to any one organisation other than the UK government will be £1.3m.

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:

	Maximum Cash Limit
Any single organisation, except the UK Central Government	£1.5m
UK Central Government	Unlimited
Any group of organisations under the same ownership	£1.5m per group
Registered Providers (Housing Associations)	£2m
Unsecured Investments with Building Societies	£1.5m
Money Market Funds	£2m
Foreign Countries	£1.5m

9.4 Liquidity Management

The Commissioner’s cash flow forecasts are updated regularly throughout the year to determine the maximum period for with funds may prudently be committed. Current forecasts are compiled on a prudent basis to minimise the risk of the Commissioner being force to borrow on unfavourable terms to meet their financial commitments. Limits on long-term investments are set by reference to the Commissioner’s medium term financial plan and cash flow forecast.

10 Treasury Management Indicators

The Commissioner measures and manages his exposure to treasury management risks using Treasury Management indicators governing upper limits for fixed and variable rate exposure.

Security

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

	Target for ST Credit Rating
Portfolio average credit rating for Warwickshire	A-

Liquidity

The Commissioner will continue to adopt a voluntary measure of his 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
Minimum Total Cash Available for 3 months for Warwickshire	£10.0m

Interest Rate Exposures

This indicator is set to control the Commissioner's 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	**2020/21**	**2021/22**	**2022/23**
Upper limit on fixed interest rate exposure*	£44.7m	£46.6m	£46.4m
Upper limit on variable interest rate exposure	£0	£0	£0

* this is the CFR figure.

Maturity Structure of Borrowing

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

	Upper	**Lower**
Under 12 Months	100%	0%
12 Months and within 24 Months	100%	0%
24 Months and within 5 Years	100%	0%
5 Years and within 10 Years	100%	0%
10 Years and above Use additional periods above 10 years if there	100%	0%

is a large amount of debt in this period		

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 Commissioner's 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	**2020/21**	**2021/22**	**2022/23**
Limit on principal invested >1year	£2m	£2m	£2m

11 Other Items

The CIPFA Code requires the Authority to include the following 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 Commissioner 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.

The Commissioner 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

The needs of the Commissioner's 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 will continue to 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.

Investment Advisers: The Commissioner has 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 Commissioner is 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 Commissioner's overall management of its treasury risks.

The total amount borrowed will not exceed the authorised borrowing limit of £45m. The maximum period between borrowing and expenditure is expected to be two years, although the Commissioner is not required to link particular loans with particular items of expenditure.

12 Financial Implications

12.1 The budget for investment income in 2020/21 is £80k, based on an average investment portfolio of £12.3 million at an interest rate of 0.65%. The budget for debt interest paid in 2020/21 is £0.554m, based on an average debt portfolio of £12.13m at an average interest rate of 4.66%. 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 CIPFA Code does not prescribe any particular treasury management strategy for local authorities to adopt. The Treasurer having consulted the 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 income.	Higher investment balance leading to a higher impact in the event 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.

APPENDIX A

POLICE AND CRIME COMMISSIONER FOR WARWICKSHIRE

Prudential Indicators and MRP Statement 2020/21

Prudential Indicators 2020/21

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	2019/20 Latest Forecast £m	2020/21 Estimate £m	2021/22 Estimate £m	2022/23 Estimate £m
Total Expenditure	**7.043**	**17.408**	**6.159**	**4.599**
Capital Receipts	0.045	0.850	0	0
Government Grants	0.434	0.113	0.113	0.113
Reserves	0.012	1.403	1.403	0.403
Revenue	4.187	5.000	0.000	0.000
Borrowing	2.365	10.042	4.643	4.083
Total Financing	**7.043**	**17.408**	**6.159**	**4.599**

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	31.03.20 Revised £m	31.03.21 Estimate £m	31.03.22 Estimate £m	31.03.23 Estimate £m
Total CFR	**30.291**	**44.658**	**46.571**	**46.642**

The CFR is forecast to rise by nearly £7m 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	31.03.20 Revised £m	31.03.21 Estimate £m	31.03.22 Estimate £m	31.03.23 Estimate £m
Total Borrowing	**14.500**	**24.893**	**29.872**	**33.290**

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	2019/20 Revised £m	2020/21 Estimate £m	2021/22 Estimate £m	2022/23 Estimate £m
Total Debt	**30.000**	**35.000**	**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	2019/20 Revised £m	2020/21 Estimate £m	2021/22 Estimate £m	2022/23 Estimate £m
Total Debt	**40.000**	**45.000**	**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	2019/20 Revised %	2020/21 Estimate %	2021/22 Estimate %	2022/23 Estimate %
General Fund	1.60	2.30	4.20	4.64

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	**2020/21 Estimate £**	**2021/22 Estimate £**	**2022/23 Estimate £**
General Fund - increase in annual band D Council Tax	0.23	2.04	4.49

Annual Minimum Revenue Provision Statement 2020/21

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 2020/21 will not be subject to a MRP charge until 2020/21.

Based on the PCC's estimate of its Capital Financing Requirement on 31st March 2020 at the time of setting the budget, the budget for MRP has been set as follows:

	31.03.2020 Estimated CFR £m	**2020/21 Estimated MRP £m**
Capital expenditure before 01.04.2008	11.430	0.286
Unsupported capital expenditure after 31.03.2008	15.196	0.685
Total General Fund	**26.626**	**0.971**

APPENDIX B

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.