Joint Audit and Standards Committee

17 March 2021

Warwickshire Police & Crime Commissioner Treasury Management Strategy 2021/2022

Recommendations

That:

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

a) the Treasury Management Strategy and Investment Strategy for 2021/22 be approved by the Police and Crime Commissioner for Warwickshire;

b) the Prudential Indicators agreed as part of the 2021/22 budget setting process and now updated to reflect the latest 2020/21 forecast outturn are (see **Appendix A)** noted;

c) the Commissioner requires the Treasurer to ensure that net borrowing does not exceed the Prudential levels specified in **Appendix A,** 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 B** of the report;

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

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 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 five years to ensure that the Authority's capital investment plans are affordable, prudent and sustainable.

1.5 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

1.6 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 the 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 and Standards Committee

1.8 The suggested strategy for 2021/22 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 their expert treasury advisers.

1.9 The strategy covers:

- Treasury limits for 2021/22 to 2025/26
- Prudential indicators
- External and local content
- Borrowing strategy
- Debt rescheduling
- Annual 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.

1.11 The 2021/22 capital and revenue budget, the medium term financial plan and prudential indicators were all approved by the Commissioner in February 2021. This Treasury Management Strategy incorporates those budgets, but uses a more recent forecast outturn for 2020/21 on the capital programme, and the likely borrowing position and as such any differences between this strategy and the prudential indicators contained in the budget report demonstrate the ongoing process for reviewing the capital position that is undertaken by the force and PCC. The 2020/21 forecast outturn for capital is lower than envisaged when the budget was set, due to slippage on some schemes, and as such, once approved this strategy and the figures contained within it supersede those included in the budget report. The Commissioners capital plans are affordable and this Treasury Management Strategy sets the criteria and limits for the anticipated treasury activity to deliver those plans in 2021/22 and beyond.

2 Treasury Limits for 2021/22 to 2025/26

2.1 The Commissioner is required to determine and keep under review how much he 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 him 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 or more successive financial years. Details of the Authorised Limit can be found in **Appendix A** of this report.

2.4 The Commissioners current treasury portfolio is as follows:

Treasury Portfolio at 31st January 2019	Principal £m	Average Rate %
Fixed Rate Funding Public Works Loans Board	 12.1	 5.026
Investments In House Externally Managed	 (4.0) 0.0	 0.50 0.00
Net Debt	8.1	

2.5 The Commissioner's borrowing requirements are as follows:

Borrowing Requirement	20/21 Estimate £m	21/22 Estimate £m	22/23 Estimate £m	23/24 Estimate £m	24/25 Estimate £m	25/26 Estimate £m
New borrowing*	7.4	18.5	6.4	5.6	1.0	1.0
Replacement borrowing	0.0	0.0	0.0	0.0	0.0	0.0
Total	**7.4**	**18.5**	**6.4**	**5.6**	**1.0**	**1.0**

Warwickshire had budgeted and expected to need to borrow to cover capital spending in 2020/21, however this was delayed due to spending on the capital programme being slow at the start of the year due in part to the pandemic. However, the pace of capital spending has increased during the latter half of 2020/21 to deliver the transformation, and borrowing is now very likely to be needed before 31st March 2021 or in early April 2021.

3 Prudential Indicators for 2020/21 to 2025/26

3.1 Prudential and Treasury Indicators (Appendices A 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 impact on the UK from coronavirus, together with its exit from the European Union and future trading arrangements with the bloc, will remain a major influence on the Authority's treasury management strategy for 2021/22.

The Bank of England (BoE) maintained the Bank Rate at 0.10% in November 2020 and also extended its Quantitative Easing programme by £150 billion to £895 billion. The Monetary Policy Committee voted unanimously for both, but no mention was made of the potential future use of negative interest rates. Within the latest forecasts, the Bank expects the UK economy to shrink -2% in Q4 2020 before growing by 7.25% in 2021, lower than the previous forecast of 9%. The BoE also forecasts the economy will now take until Q1 2022 to reach its pre-pandemic level rather than the end of 2021 as previously forecast.

UK Consumer Price Inflation (CPI) for September 2020 registered 0.5% year on year, up from 0.2% in the previous month. Core inflation, which excludes the more volatile components, rose to 1.3% from 0.9%. The most recent labour market data for the three months to August 2020 showed the unemployment rate rose to 4.5% while the employment rate fell to 75.6%. Both measures are expected to deteriorate further due to the ongoing impact of coronavirus on the jobs market, particularly when the various government job retention schemes start to be unwound in 2021, with the BoE forecasting unemployment will peak at 7.75% in Q2 2021. In August, the headline 3-month average annual growth rate for wages were 0% for total pay and 0.8% for regular pay. In real terms, after adjusting for inflation, total pay growth fell by -0.8% while regular pay was up 0.1%.

GDP growth fell by -19.8% in the second quarter of 2020, a much sharper contraction from -2.0% in the previous three months, with the annual rate falling -21.5% from -1.6%. All sectors fell quarter-on-quarter, with dramatic declines in construction (-35.7%), services (-19.2%) and production (-16.3%), and a more modest fall in agriculture (-5.9%). Monthly GDP estimates have shown the economy is recovering but remains well below its pre-pandemic peak. Looking ahead, the BoE's November Monetary Policy Report forecasts economic growth will rise in 2021 with GDP reaching 11% in Q4 2021, 3.1% in Q4 2022 and 1.6% in Q4 2023.

GDP growth in the euro zone rebounded by 12.7% in Q3 2020 after contracting by -3.7% and -11.8% in the first and second quarters, respectively. Headline inflation, however, remains extremely weak, registering -0.3% year-on-year in October, the third successive month of deflation. Core inflation registered 0.2% y/y, well below the European Central Bank's (ECB) target of 'below, but close to 2%'. The ECB is expected to continue holding its main interest rate of 0% and deposit facility rate of -0.5% for some time with further monetary stimulus expected later in 2020.

The US economy contracted at an annualised rate of 31.7% in Q2 2020 and then rebounded by 33.1% in Q3. The Federal Reserve maintained the Fed Funds rate at between 0% and 0.25% and announced a change to its inflation targeting regime to a more flexible form of average targeting. The Fed also provided strong indications that interest rates are unlikely to change from current levels over the next three years. Former vice-president Joe Biden won the 2020 US presidential election. Mr Biden is making tackling coronavirus his immediate priority and will also be reversing several executive orders signed by his predecessor and take the US back into the Paris climate accord and the World Health Organisation.

4.1 Credit Outlook

After spiking in late March as coronavirus became a global pandemic, credit default swap (CDS) prices for the larger UK banks have steadily fallen back to almost pre-pandemic levels. Although uncertainly around COVID-19 related loan defaults led to banks provisioning billions for potential losses in the first half of 2020, drastically reducing profits, reported impairments for Q3 were much reduced in some institutions. However, general bank profitability in 2020 is likely to be significantly lower than in previous years.

The credit ratings for many UK institutions were downgraded on the back of downgrades to the sovereign rating. Credit conditions more generally though in banks and building societies have tended to be relatively benign, despite the impact of the pandemic.

Looking forward, the potential for bank losses to be greater than expected when government and central bank support starts to be removed remains a risk, and despite the UK reaching a Brexit deal, there remains some confusion around taxation and logistics between the UK and EU and this is a negative factor for many companies, suggesting a cautious approach to bank deposits in 2021/22 remains advisable.

4.2 Interest Rate Forecast

The Authority's treasury management adviser Arlingclose is forecasting that the BoE Bank Rate will remain at 0.1% until at least the end of 2023. The risks to this forecast are judged to be to the downside as the BoE and UK government continue to react to the coronavirus pandemic. The BoE extended its asset purchase programme to £895 billion in November while keeping Bank Rate on hold. However, further interest rate cuts to zero, or possibly negative, cannot yet be ruled out but this is not part of the Arlingclose central forecast.

Gilt yields are expected to remain very low in the medium-term while short-term yields are likely to remain below or at zero until such time as the BoE expressly rules out the chance of negative interest rates or growth/inflation prospects improve. The central case is for the 10-year and 20-year position to rise to around 0.5% and 0.75% respectively over the time horizon. The risks around the gilt yield forecasts are judged to be broadly balanced between upside and downside risks, but there will almost certainly be short-term volatility due to economic and political uncertainty and events.

A more detailed economic and interest rate forecast provided by Arlingclose is attached at Appendix A. However, for the purpose of setting the 2021/22 budget, it was assumed that new treasury investments would be made at an average rate of 0.1%, and that new long-term loans will be borrowed at an average rate of 1.5%.

4.3 Markets in Financial Instruments Directive (MIFID):

In January 2018 the PCC for Warwickshire elected for professional client status. This allows access to a greater range of services, but with the protections afforded to individuals and small companies. At present to remain as a professional client the Commissioner requires an investment portfolio of at least £10m. The investments will be closely monitored during 2020/2021 and the future forecast years of this strategy, to ensure that the portfolio is classed correctly. Advice from Arlingclose will also be sought to ensure that this 'status' remains appropriate.

5 Local Context

It is estimated that as at the 31st March 2021 Warwickshire will hold £22.295m of borrowing and no investments. This is set out in further detail at Appendix A. Forecast changes in these sums are shown in the balance sheet analysis in the table below.

Table 1 Balance Sheet Summary and Forecast

	31.03.20 Actual £m	31.03.21 Estimate £m	31.03.22 Forecast £m	31.03.23 Forecast £m	31.03.24 Forecast £m	31.03.25 Forecast £m	31.03.26 Forecast £m
Funding:							
Borrowing CFR	23.979	30.308	47.770	53.101	57.659	57.223	57.055
Less: External Borrowing**	12.135	18.553	35.989	40.759	44.320	43.062	41.959
Internal (over) Borrowing	**11.844**	**11.755**	**11.782**	**12.342**	**13.339**	**14.161**	**15.096**
Less:							
Usable Reserves	(21.000)	(10.703)	(11.823)	(10.853)	(10.319)	(10.004)	(10.016)
Working Capital	4.296	(1.151)	(1.262)	(1.929)	(3.020)	(4.157)	(5.080)
Investments	**(4.860)**	**(0.099)**	**(1.303)**	**(0.440)**	**0**	**0**	**0**

6 Borrowing Strategy

6.1 At 31st March 2021, the PCC will hold £18.553 million of loans, an increase of £7.4 million on the previous year, as part of its strategy for funding previous years' capital programmes. The balance sheet forecast in table 1 shows that the PCC expects to borrow up to £18.6m in 2021/22. The PCC may also borrow additional sums to pre-fund future years' requirements, providing this does not exceed the authorised limit for borrowing of £60 million in 2021/22.

6.2 Objectives: The PCC;s chief objective when borrowing money is 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 PCC's long-term plans change is a secondary objective.

6.3 Strategy: Given recent reductions in core funding and the financial challenges, the PCC'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 or medium term loans instead.

By doing so, the Authority is able to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk. The benefits of 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 the PCC with this 'cost of carry' and breakeven analysis. Its output may determine whether the PCC borrows additional sums at long-term fixed rates in 2021/22 with a view to keeping future interest costs low, even if this causes some additional cost in the shorter-term.

The PCC has not undertaken any long term borrowing for some time, but it has previously raised all of its long-term borrowing from the PWLB. In future it will consider long-term loans from other sources where appropriate, including banks, pensions and local authorities, and will investigate the possibility of issuing bonds and similar instruments, in order to lower interest costs and reduce over-reliance on one source of funding in line with the CIPFA Code. PWLB loans are no longer available to local authorities or PCC's planning to buy investment assets primarily for yield; the Authority intends to avoid this activity in order to retain its access to PWLB loans. Alternatively, the PCC may consider arranging forward starting loans, 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. All of these will be considered based on advice from Arlingclose as their expert advisors at an appropriate time.

In addition, the PCC 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

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

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.

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, which is 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 the Commissioner will seek to minimise his future borrowings by using revenue budget under spends to defray borrowing where this is feasible and prudent or other sources of capital finance including capital receipts if they are realised. .

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. Annual Investment Strategy

Investment Policy

8.1 The Commissioner will have regard to the MHCLG'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 MHCLG 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 their 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, 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 any 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.

Treasury Investment counterparty and limits

Sector	Time limit	Counterparty limit	Sector limit
The UK Government	50 years	Unlimited	n/a
Local authorities & other government entities	25 years	£2m	Unlimited
Secured investments *	25 years	£2m	Unlimited
Banks (unsecured) *	13 months	£2m	Unlimited
Building societies (unsecured) *	13 months	£2m	£5m
Registered providers (unsecured) *	5 years	n/a	£12m
Money market funds *	n/a	£5m	Unlimited
Strategic pooled funds	n/a	n/a	£25m
Real estate investment trusts	n/a	n/a	£12m
Other investments *	5 years	£2m	£5m

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

* **Minimum credit rating:** Treasury investments in the sectors marked with an asterisk will only be made with entities whose lowest published long-term credit rating is no lower than A-. 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.

For entities without published credit ratings, investments may be made either (a) where external advice indicates the entity to be of similar credit quality; or (b) to a maximum of £2,000,000 per counterparty as part of a diversified pool e.g. via a peer-to-peer platform.

Government: Loans to, and 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 Government are deemed to be zero credit risk due to its ability to create additional currency and therefore may be made in unlimited amounts for up to 50 years.

Secured investments: Investments secured on the borrower's assets, which limits the potential losses in the event of insolvency. The amount and quality of the security will be a key factor in the investment decision. Covered bonds and reverse repurchase agreements with banks and building societies 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. The combined secured and unsecured investments with any one counterparty will not exceed the cash limit for secured investments.

Banks and building societies (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.

Registered providers (unsecured): Loans to, and bonds issued or guaranteed by, registered providers of social housing or registered social landlords, formerly known as housing associations. These bodies are 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.

Money market funds: Pooled funds that offer same-day or short notice liquidity and very low or no price volatility by investing in short-term money markets. They have the advantage over bank accounts of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a small fee. Although no sector limit applies to money market funds, the Authority will take care to diversify its liquid investments over a variety of providers to ensure access to cash at all times.

Strategic pooled funds: Bond, equity and property funds that offer enhanced returns over the longer term but are more volatile in the short term. These allow the Authority 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 Authority's investment objectives will be monitored regularly.

Real estate investment trusts: Shares in companies that invest mainly in real estate and pay the majority of their rental income to investors in a similar manner to pooled property funds. As with property funds, REITs offer enhanced returns over the longer term, but are more volatile especially as the share price reflects changing demand for the shares as well as changes in the value of the underlying properties.

Other investments: This category covers treasury investments not listed above, for example unsecured corporate bonds and company loans. Non-bank companies cannot be bailed-in but can become insolvent placing the Authority's investment at risk.

Operational bank accounts: The Authority 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 have previously been kept below £5 million per bank, however during the pandemic we cashed in our 'Call account' with Santander for liquidity reasons, to give more flexibility around payments for potential overtime requirement, and for ICT investments and our new transactional services solution. The PCC will redeposit in this account in 2021/22 to mitigate the risk of holding all our cash in one 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.

8.10 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,
- 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 2020, this is not generally reflected in credit ratings, but can be seen in other market measures. In these circumstances, the Commissioner will restrict his investments to those organisations of higher credit quality and reduce the maximum duration of his 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 investment returns to fall, but will protect the principal sum invested.

9. Investment Limits

9.1 The Commissioner's revenue reserves available to cover investment losses are estimated to be £10.703m on 31st March 2021. In order that no more than 20% 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 £2m. Money market funds are not treated as a single organisation due their diversified entities.

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:

	Cash limit
Any group of pooled funds under the same management	£5m per manager
Foreign countries	£2m per country

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
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
Total Cash Available for 3 months for Warwickshire	£5m

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 of net principal borrowed will be:

Warwickshire	**2021/22**	**2022/23**	**2023/24**	**2024/25**	**2025/26**
Upper limit on fixed interest rate exposure (CFR)	£47.770m	£53.101m	£57.659m	£57.223m	£57.055m

Upper limit on variable interest rate exposure	£5m	£5m	£5m	£5m	£5m

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	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 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	**2021/22**	**2022/23**	**2023/24**	**2024/25**	**2025/26**
Limit on principal invested beyond year end	£3m	£2m	£2m	£2m	£2m

11 Other Items

The CIPFA Code requires the PCC 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 attend training courses, sector updates, seminars and conferences provided by Arlingclose and CIPFA. Relevant staff are also encouraged to study professional qualifications from CIPFA and other appropriate organisations. The intention is to set up some formal training with Arlingclose for key staff later this year.

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 £20k, based on an average investment portfolio of £15 million at an interest rate of 0.5%. The budget for debt interest paid in 2020/21 is £0.708m, based on an average debt portfolio of £16m at an average interest rate of 4.7%. If actual levels of investments and borrowing, and actual interest rates differ from those forecast, performance against budget will be correspondingly different.

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13 Other Options Considered

The CIPFA Code does not prescribe any particular treasury management strategy for local authorities or PCC's to adopt. The Treasurer having taken the advice of relevant staff and consulted with 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 however 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 2021/22

Prudential Indicators 2021/22

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	2020/21 Forecast £m	2021/22 Estimate £m	2022/23 Estimate £m	2023/24 Estimate £m	2024/25 Estimate £m	2025/26 Estimate £m
Total Expenditure	**7.960**	**18.757**	**7.136**	**6.720**	**5.399**	**5.580**
Capital Receipts	0.000	0.000	0.000	0.000	0.000	0.000
Government Grants	0.560	0.213	0.701	0.213	0.213	0.213
Reserves	0.000	0.000	0.000	0.000	0.000	0.000
Revenue	0.000	0.000	0.000	0.000	0.000	0.000
Borrowing	7.400	18.544	6.435	5.657	0.686	0.866
Total Financing	**7.960**	**15.483**	**6.576**	**6.720**	**5.399**	**5.580**

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	31.03.21 Revised £m	31.03.22 Estimate £m	31.03.23 Estimate £m	31.03.24 Estimate £m	31.03.25 Estimate £m	31.03.26 Estimate £m
Total CFR	**30.308**	**47.770**	**53.101**	**57.659**	**57.223**	**57.055**

The CFR is forecast to rise by nearly £26.8m over the next three years as capital expenditure financed by debt outweighs resources put aside for debt repayment. This is largely around the Evolve project which not only aims to put the Force back on a stand-alone footing, but is introducing modern technology for officers and staff including improved communications. We will also be updating our properties around the Force, and a full Estates strategy is under way.

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	31.03.21 Revised £m	31.03.22 Estimate £m	31.03.23 Estimate £m	31.03.24 Estimate £m	31.03.25 Estimate £m	31.03.26 Estimate £m
Total Borrowing	18.553	35.989	40.759	44.320	43.062	41.959

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	2020/21 Revised £m	2021/22 Estimate £m	2022/23 Estimate £m	2023/24 Estimate £m	2024/25 Estimate £m	2025/26 Estimate £m
Total Debt	35.000	50.000	55.000	60.000	60.000	60.000

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 Li	2020/21 Revised £m	2021/22 Estimate £m	2022/23 Estimate £m	2023/24 Estimate £m	2024/25 Estimate £m	2025/26 Estimate £m
Total Debt	45.000	60.000	65.000	70.000	70.000	70.000

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	2020/21 Revised %	2021/22 Estimate %	2022/23 Estimate %	2023/24 Estimate %	2024/25 Estimate %	2025/26 Estimate %
General Fund	1.49	1.54	2.00	2.13	2.31	2.25

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 £	2023/24 Estimate £	2024/25 Estimate £	2025/26 Estimate £
General Fund - increase in annual band D Council Tax	(0.05)	0.15	1.11	0.29	0.40	(0.14)

Annual Minimum Revenue Provision Statement 2021/22

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 Ministry of Housing, Communities and Local Government's *Guidance on Minimum Revenue Provision* (the MHCLG Guidance) most recently issued in 2012.

The broad aim of the MHCLG 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 MHCLG 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 2021/22.

Based on the PCC's estimate of its Capital Financing Requirement on 31st March 2021 at the time of setting the budget, the budget for MRP has been set as follows:

	31.03.2021 Estimated CFR £m	**2021/22 Estimated MRP £m**
Capital expenditure before 01.04.2008	11.430	0.286
Unsupported capital expenditure after 31.03.2008	18.878	1.284
Total	**30.308**	**1.081**

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.