Agenda item: 19

Warwickshire Joint Audit and Standards Committee Report Summary

Meeting Date:	**15th March 2023**
Subject:	**Treasury Management Strategy report 2023/24**
Contact details:	**Mike Kaine**

Purpose of the report

To set out the Commissioner's Treasury Management Strategy, including the Annual Investment Strategy and the Minimum Revenue Provision Policy for 2023/24.

Recommendations

That:

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

a) the Treasury Management Strategy and Investment Strategy for 2023/24 be approved by the Police and Crime Commissioner for Warwickshire;

b) the Prudential Indicators agreed as part of the respective budget setting process (see **Appendix A)** are 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 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 Commissioner's investments, borrowing, cash flows, 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 (yield): this is known as the SLY principle – Security, Liquidity, Yield.

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 ensure that the Commissioner'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 Commissioner's 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 Commissioner 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 the 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 2023/24 in respect of the following aspects of the treasury management function is based upon the Treasurer's and the Force Financial Accounting Team's (who undertake treasury management on behalf of the Commissioner) views on interest rates, supplemented with leading market forecasts provided by treasury advisers (Arlingclose).

1.9 The strategy covers:

- Treasury limits for 2023/24 to 2027/28
- 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 balances.

2 Treasury Limits for 2023/24 to 2026/27

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 successive financial years. Details of the Authorised Limit can be found in **Appendix A** of this report.

2.4 The Commissioner’s current treasury portfolio is as follows:

Treasury Portfolio at 31st January 2023	**Principal £m**	**Average Rate %**
Fixed Rate Funding Public Works Loans Board Short-term borrowing	 18.9 0.0	 3.50
Investments In House Externally Managed	 (4.6) 0.0	 3.57
Net Debt	**14.3**	

2.5 The Commissioner’s borrowing requirements are as follows:

Borrowing Requirement	**21/22 Actual £m**	**22/23 Forecast £m**	**23/24 Forecast £m**	**24/25 Forecast £m**	**25/26 Forecast £m**	**26/27 Forecast £m**
New borrowing*	9,790	1.500	3.661	4.178	3.940	3.588
Replacement borrowing	0.0	0.0	0.0	0.0	0.0	0.0
Total	**9.790**	**1.500**	**3.661**	**4.178**	**3.940**	**3.588**

* The borrowing requirement for 2021/22 was funded externally from PWLB borrowing, future years may also be funded in this way or a combination of “internal” (surplus cash) and external borrowing.

As the second instalment of the capital receipt for the sale of a plot of unused land at Leek Wootton will be received in February 2023, there is only a small borrowing requirement in 2022/23 and we therefore do not expect to need to take out new long-term borrowing in 2022/23, although timings of cash flows may mean that we need to take out some short-term borrowing before 31st March 2023. The forecast also assumes larger revenue contributions to capital will be made each year from 2022/23 onwards, partly funded by vetting income.

3 Prudential Indicators for 2022/23 to 2026/27

3.1 Prudential and Treasury Indicators (Appendix 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

4.1 Economic background

The ongoing impact on the UK from the war in Ukraine, together with higher inflation, higher interest rates, uncertain government policy, and a deteriorating economic outlook, will be major influences on the Authority's treasury management strategy for 2023/24.

The Bank of England (BoE) increased Bank Rate by 0.5% to 3.5% in December 2022 (and subsequently by 0.5% to 4.0% in February 2023). This followed a 0.75% rise in November which was the largest single rate hike since 1989 and the ninth successive rise since December 2021. The December decision was voted for by a 6-3 majority of the Monetary Policy Committee (MPC), with two dissenters voting for a no-change at 3% and one for a larger rise of 0.75%.

The November quarterly Monetary Policy Report (MPR) forecast a prolonged but shallow recession in the UK with CPI inflation remaining elevated at over 10% in the near-term. Subsequent forecasts are suggesting that recession may be avoided, albeit growth will be low. While the projected peak of inflation is lower than in the August report, due in part to the government's support package for household energy costs, inflation is expected remain higher for longer over the forecast horizon and the economic outlook remains weak, with unemployment projected to start rising.

The UK economy contracted by 0.3% between July and September 2022 according to the Office for National Statistics, and the BoE forecasts Gross Domestic Product (GDP) will decline 0.75% in the second half of the calendar year due to the squeeze on household income from higher energy costs and goods prices. Growth is then expected to continue to fall throughout 2023 and the first half of 2024.

CPI inflation is expected to have peaked at around 11% in the last calendar quarter of 2022 and then fall sharply to 1.4%, below the 2% target, in two years' time and to 0% in three years' time if Bank Rate follows the path implied by financial markets at the time of the November MPR (a peak of 5.25%). However, the BoE stated it considered this path to be too high, suggesting that the peak in interest rates will be lower, reducing the risk of inflation falling too far below target. Market rates have fallen since the time of the November MPR.

The labour market remains tight for now, with the most recent statistics showing the unemployment rate was 3.7%. Earnings were up strongly in nominal terms by 6.1% for both total pay and for regular pay but factoring in inflation means real pay for both measures was -2.7%. Looking forward, the November MPR shows the labour market weakening in response to the deteriorating outlook for growth, leading to the unemployment rate rising to around 6.5% in 2025.

Interest rates have also been rising sharply in the US, with the Federal Reserve increasing the range on its key interest rate by 0.5% in December 2022 to 4.25%-4.5%. This rise follows four successive 0.75% rises in a pace of tightening that has seen rates increase from 0.25%-0.50% in March 2022. Annual inflation has been slowing in the US but remains above 7%. GDP grew at an annualised rate of 3.2% (revised up from 2.9%) between July and September 2022, but with official interest rates expected to rise even further in the coming months, a recession in the region is widely expected at some point during 2023.

Inflation rose consistently in the Euro Zone since the start of the year, hitting a peak annual rate of 10.6% in October 2022, before declining to 10.1% in November. Economic growth has been weakening with an upwardly revised expansion of 0.3% (from 0.2%) in the three months to September 2022. As with the UK and US, the European Central Bank has been on an interest rate tightening cycle, pushing up its three key interest rates by 0.50% in December, following two consecutive 0.75% rises, taking its main refinancing rate to 2.5% and deposit facility rate to 2.0%.

4.2 Credit Outlook

Credit default swap (CDS) prices have generally followed an upward trend throughout 2022, indicating higher credit risk. They have been boosted by the war in Ukraine, increasing economic and political uncertainty and a weaker global and UK outlook, but remain well below the levels seen at the beginning of the Covid-19 pandemic.

CDS price volatility was higher in 2022 compared to 2021 and the divergence in prices between ringfenced (retail) and non-ringfenced (investment) banking entities has emerged once again.

The weakening economic picture during 2022 led the credit rating agencies to reflect this in their assessment of the outlook for the UK sovereign as well as several local authorities and financial institutions, revising them from to negative from stable.

There are competing tensions in the banking sector which could impact bank balance sheet strength going forward. The weakening economic outlook and likely recessions in many regions increase the possibility of a deterioration in the quality of banks' assets, while higher interest rates provide a boost to net income and profitability.

However, the institutions on our adviser Arlingclose's counterparty list remain well-capitalised and their counterparty advice on both recommended institutions and maximum duration remain under constant review and will continue to reflect economic conditions and the credit outlook.

4.3 Interest Rate Forecast

The Authority's treasury management adviser Arlingclose forecasts that Bank Rate will continue to rise in 2022 and 2023 as the Bank of England attempts to subdue inflation which is significantly above its 2% target.

While interest rate expectations reduced during October and November 2022, multiple interest rate rises are still expected over the forecast horizon despite looming recession. Arlingclose expects Bank Rate to rise to 4.25% by June 2023 under its central case, with the risks in the near- and medium-term to the upside should inflation not evolve as the Bank forecasts and remains persistently higher.

Yields are expected to remain broadly at current levels over the medium-term, with 5-, 10- and 20-year gilt yields expected to average around 3.5%, 3.5%, and 3.85% respectively over the 3-year period to December 2025. The risks for short, medium and longer-term yields are judged to be broadly balanced over the forecast horizon. As ever, there will undoubtedly be short-term volatility due to economic and political uncertainty and events.

For the purpose of setting the budget, it has been assumed that new treasury investments will be made at an average rate/yield of 2%, and that new long-term loans will be borrowed at an average rate of 3.5%.

5 Local Context

5.1 It is estimated that as at 31st March 2023, the Commissioner will hold £19.2m of borrowing and a minimal level of investments. Forecast changes in these sums are shown in the balance sheet analysis in table 5.1. Ideally working capital would be at a minimal level at each year end and normally cash and investments would also be close to zero. In practice this can vary depending on the timing of the April pensions payroll payment (c.£2m) and other large payments around year end (eg PWLB loan repayments). Levels of cash and investments vary throughout the year, peaking in July when the pensions top-up grant is received from the Home Office (c.£15m).

Table 5.1 Balance Sheet Summary and Forecast

	31.03.22 Actual £m	**31.03.23 Forecast £m**	**31.03.24 Forecast £m**	**31.03.25 Forecast £m**	**31.03.26 Forecast £m**	**31.03.27 Forecast £m**
Funding:						
Borrowing CFR	40.284	38.027	37.757	37.598	36.795	35.373
Less: External Borrowing	(23.156)	(19.229)	(20.226)	(22.062)	(23.654)	(24.918)
Internal Borrowing	**17.128**	**18.798**	**17.531**	**15.536**	**13.141**	**10.455**
Less Balance Sheet Resources:						
Usable Reserves (incl Capital Receipts Reserve)	(19.117)	(14.897)	(11.103)	(10.595)	(9,652)	(9.323)
Less: Working Capital	(1.942)	(4.901)	(8.428)	(6.941)	(5.489)	(3.132)
Cash and Investments	**(3.931)**	**(1.000)**	**(2.000)**	**(2.000)**	**(2.000)**	**(2.000)**

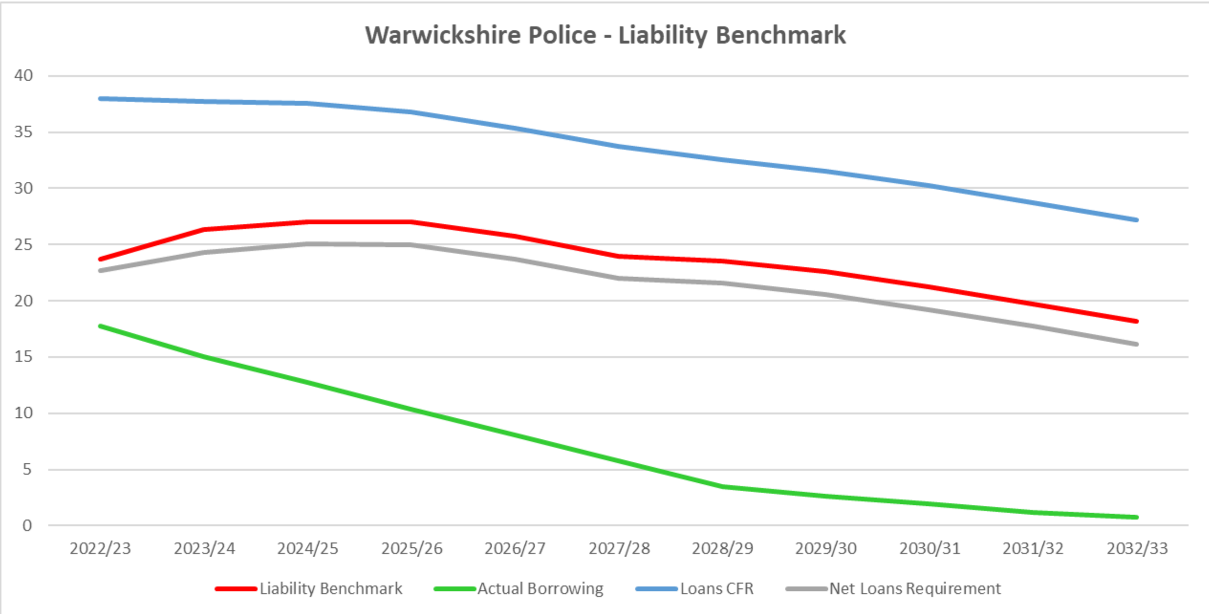
The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while balance sheet resources are the underlying sums available for investment. The Commissioner's current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing.

CIPFA's Prudential Code for Capital Finance in Local Authorities recommends that the Authority's total debt should be lower than its highest forecast CFR over the next three years. Table 5.1 shows that the Authority expects to comply with this recommendation during 2023/24.

5.2 Liability benchmark: To compare the Commissioner's actual borrowing against an alternative strategy, a liability benchmark has been calculated showing the lowest risk level of borrowing. This assumes the same forecasts as table 5.1 above and that cash and investment balances are kept to a minimum level of £2m at each year-end to maintain sufficient liquidity but minimise credit risk.

The liability benchmark is an important tool to help establish whether the Commissioner is likely to be a long-term borrower or long-term investor in the future, and so shape his strategic focus and decision making. The liability benchmark itself represents an estimate of the cumulative amount of external borrowing the Commissioner must hold to fund his current capital and revenue plans while keeping treasury investments at the minimum level required to manage day-to-day cash flow.

Table 5.2: Prudential Indicator: Liability benchmark



The liability benchmark is a new treasury management prudential indicator in the 2021 edition of the CIPFA Treasury Management Code. The liability benchmark indicator has to be included for the first time in the 2023/24 Treasury Management Strategy.

Unlike other indicators, the liability benchmark is to be shown graphically for a minimum of ten years. It consists of four lines – the loans capital financing requirement (LCFR), the net loans requirement (NLR) and the liability benchmark itself (LB) plus a line for actual borrowing.

The concept is that the chart allows a comparison of current borrowing against the need to borrow. Where the LB exceeds actual loans held, the PCC can take long-term borrowing.

The LCFR can be described as the maximum permitted level of borrowing (effectively the Capital Financing Requirement). But borrowing up to the LCFR will usually mean high levels of investments, exposing the authority to credit, price and interest rate risks.

The NLR is the minimum possible level of borrowing, at which investments would be zero. This would expose the authority to the liquidity risk of being unable to make payments when due. Actual debt levels below this line would indicate "internal borrowing".

The LB is then the optimal point between the two, where an appropriate balance of risks can be struck between these two extremes.

For the PCC for Warwickshire, the chart shows that although the Capital Financing Requirement (blue line) decreases over time - due to forecasted new borrowing requirements each year being lower than the forecasted annual Minimum Revenue Provision charges - the level of actual debt (green line) decreases at a faster rate as existing loans mature. The gap between the blue line (CFR) and the green line demonstrates the level of internal borrowing as set out in Table 5.1. The actual borrowing shown on the green line does not take account of the projected future borrowing shown in the table in 5.1, it is only plots the maturity of the current borrowing.

The Net Loans Requirement (grey line) takes into account usable reserves and working capital (Creditors minus Debtors) but assumes investments are zero. The Liability Benchmark assumes that investments will be maintained at around £2m (as explained in 5.1 above). Therefore, the difference between the LB and the actual borrowing is the suggested ideal level of new borrowing that could be required over the period of the chart, taking into account levels of usable reserves, working capital, and investments.

6 Borrowing Strategy

6.1 The balance sheet forecast in table 5.1 shows that the Commissioner expects to borrow around £1m net in 2023/24 - £3.7m new loans to fund the capital programme less repayments of existing debt of £2.6m. At 31st March 2023, the Commissioner will hold £19.2m of external loans, (£23.2m as at 31.03.2022), a decrease of £4m after in-year repayments of short- and long-term loans during the year. The Commissioner may also borrow additional sums to pre-fund future years' requirements, providing this does not exceed the authorised limit for borrowing of £50 million.

6.2 **Objectives:** The Commissioner'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 Commissioner's long-term plans change is a secondary objective.

6.3 **Strategy:** Given the significant cuts to public expenditure and in particular to local government funding, 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 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 Commissioner 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 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 2023/24 with a view to keeping future interest costs low, even if this causes additional cost in the short-term.

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.

The Commissioner has previously raised all of his long-term borrowing from the PWLB but will consider 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. PWLB loans are no longer available to local authorities planning to buy investment assets primarily for yield; the Commissioner intends to avoid this activity in order to retain its access to PWLB loans.

Alternatively, the Commissioner may arrange 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.

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

Sources of borrowing:

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

- HM Treasury's PWLB lending facility (formerly the Public Works Loan Board);
- any institution approved for investments (see below);
- 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 Pension Fund);
- capital market bond investors;
- UK Municipal Bonds Agency plc and other special purpose companies created to enable local authority bond issues.

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.

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

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.

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 6 above, and
- enhancing the balance of the portfolio (amending the maturity profile and / or the balance of volatility)

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.

The recent rise in interest rates means that more favourable debt rescheduling opportunities should arise than in previous years.

8. Annual Investment Strategy

8.1 Investment Policy

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 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. The Authority aims to be a responsible investor and will consider environmental, social and governance (ESG) issues when investing.

The Commissioner's investment priorities are the security of capital and the liquidity of investments.
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.

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.

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.

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.

The Commissioner may invest his surplus funds with any of the counterparty types in Table 8.1 below, subject to the cash limits (per counterparty) and the time limits shown.

Table 8.1 Approved Investment Counterparts and Limits.

<u>Treasury Investment counterparty and limits</u>

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

The Commissioner's Bankers (Lloyds) *	13 months	£5m	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 £2m 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 Commissioner 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 Commissioner 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 Commissioner’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 Commissioner’s investment at risk.

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 have previously been kept below £5 million 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 Commissioner 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; 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 2020, 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 investment returns to fall but will protect the principal sum invested.

9. Investment Limits

The Commissioner's revenue reserves available to cover investment losses are estimated to be £14.9m on 31st March 2023. 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 and the Commissioner's bankers (Lloyds) will be £2m. Money market funds are not treated as a single organisation due their diversified entities.

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

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

Liquidity Management

The Commissioner’s cash flow forecasts are updated regularly throughout the year to determine the maximum period for which funds may prudently be committed. Current forecasts are compiled on a prudent basis to minimise the risk of the 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.

10.1 Security

The Commissioner has adopted 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-

10.2 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 within 3 months	£15m

10.3 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	**2022/23**	**2023/24**	**2024/25**	**2025/26**	**2026/27**
Upper limit on fixed interest rate exposure (CFR)	£38.0m	£38.0m	£38.0m	£37.0m	£35.0m
Upper limit on variable interest rate exposure	£5m	£5m	£5m	£5m	£5m

10.4 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	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.

10.5 Long-term treasury management investments

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	2023/24	2024/25	2025/26	2026/27
Limit on principal invested for longer than 365 days	£2m	£2m	£2m	£2m

11 Other Items

The CIPFA Code requires the Commissioner 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 regularly attend training courses, seminars and conferences provided by Arlingclose and / or 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.

12 Financial Implications

The budget for investment income in 2023/24 is £120k, based on an average investment portfolio of £6 million at an interest rate of 2%. The budget for debt interest payable in 2023/24 is £0.663m, based on an average debt portfolio of £18m at an average interest rate of 3.5%. If actual levels of investments and borrowing, and actual interest rates differ from these forecasts, 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 Joint Audit and Standards 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 2023/24

Prudential Indicators 2023/24

The Local Government Act 2003 requires the Commissioner 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. Please note that the new "Liability Benchmark" Indicator has been set out and explained fully in section 5 above.

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

Capital Expenditure and Financing	2022/23 Latest Forecast £m	2023/24 Estimate £m	2024/25 Estimate £m	2025/26 Estimate £m	2026/27 Estimate £m
Total Expenditure	**10.595**	**9.817**	**7.111**	**6.373**	**6.021**
Capital Receipts	4.126	1.154	0.000	0.000	0.000
Government Grants	0.378	0.500	0.000	0.000	0.000
Reserves	0.966	2.440	0.500	0.000	0.000
Revenue	3.625	2.062	2.433	2.433	2.433
Borrowing	1.500	3.661	4.178	3.940	3.588
Total Financing	**10.595**	**9.817**	**7.111**	**6.373**	**6.021**

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	31.03.23 Revised £m	31.03.24 Estimate £m	31.03.25 Estimate £m	31.03.26 Estimate £m	31.03.27 Estimate £m
Total CFR	**38.027**	**37.757**	**37.598**	**36.795**	**35.373**

The CFR is forecast to fall by around £3m over the next four years as capital expenditure financed by debt is lower than the resources put aside for debt repayment (MRP). This reduction is due to the use of revenue (including reserves) contributions to fund around half of the capital expenditure each year from 2023/24.

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	31.03.23 Revised £m	31.03.24 Estimate £m	31.03.25 Estimate £m	31.03.26 Estimate £m	31.03.27 Estimate £m
Total Borrowing	**19.229**	**20.226**	**22.062**	**23.654**	**24.918**

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	2022/23 Revised £m	2023/24 Estimate £m	2024/25 Estimate £m	2025/26 Estimate £m	2026/27 Estimate £m
Total Debt	**40.0**	**40.0**	**40.0**	**40.0**	**35.0**

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	2022/23 Estimate £m	2023/24 Estimate £m	2024/25 Estimate £m	2025/26 Estimate £m	2025/27 Estimate £m
Total Debt	**50.0**	**50.0**	**50.0**	**50.0**	**45.0**

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	2022/23 Revised %	2023/24 Estimate %	2024/25 Estimate %	2025/26 Estimate %	2025/27 Estimate %
General Fund	3.55	3.55	3.79	4.09	4.25

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	2022/23 Revised £	2023/24 Estimate £	2024/25 Estimate £	2025/26 Estimate £	2025/27 Estimate £
General Fund - increase in annual band D Council Tax	3.25	0.33	0.99	1.05	0.73

Annual Minimum Revenue Provision Statement 2023/24

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 MHCLG Guidance) most recently issued in 2018.

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 2022/23 will not be subject to a MRP charge until 2023/24.

Based on the PCC's estimate of its Capital Financing Requirement on 31st March 2023 at the time of setting the budget, the budget for MRP has been set as follows:

	31.03.2023 Estimated CFR £m	**2023/24 Estimated MRP £m**
Capital expenditure before 01.04.2008	9.716	0.286
Unsupported capital expenditure after 31.03.2008	28.311	3.645
Total General Fund	**38.027**	**3.931**

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.