Appendix 1

TREASURY MANAGEMENT STRATEGY 2018/19

1. BACKGROUND

1.1 The Police & Crime Commissioner (the Commissioner) is required to operate a balanced budget meaning that cash raised during the year from grants, council tax and other income sources will match the cash expenditure for the year. The first requirement of treasury management is to ensure that this cashflow is adequately planned with cash being available when it is needed. Surplus funds are invested in low risk counterparties or financial instruments commensurate with the low risk appetite, that offer adequate liquidity (i.e. ease of access) before considering any return on the investment. The investment strategy objectives are, in order of priority, security, liquidity and then yield.

1.2 The second main function of treasury management is the funding of the capital programme. The capital programme and plans provide a guide to the Commissioner's borrowing requirement which is essentially the longer-term cashflow planning to ensure that the capital programme commitments can be met. The management of longer-term cashflow may involve arranging long or short-term loans or by using cashflow surpluses. Any debt currently held may also be re-structured when favourable conditions arise and in line with risk and/or cost objectives.

1.3 CIPFA defines treasury management 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.'*

2. REPORTING REQUIREMENTS

2.1 The Commissioner is required to receive and approve, as a minimum, three main reports each year which incorporate policies, estimates and actual income and expenditure.

Prudential and Treasury Indicators and Treasury Strategy (this report) – the first and most important report covering:

- the capital plans (including prudential indicators);
- a minimum revenue provision (MRP) policy statement (how residual capital expenditure is charged to revenue over time);
- the Treasury Management Strategy (how the investments and borrowings are to be organised and includes the treasury management indicators); and
- an Investment Strategy (the way in which investments are to be managed).

A Mid-Year Treasury Management Report – this updates the Commissioner on the progress of the capital position, updates prudential indicators as necessary, and whether the actual execution of treasury management is in line with the Strategy or whether any policies need revision. Should there be a particularly volatile period affecting treasury management then more frequent reports will be submitted.

An Annual Treasury Management Report – this provides details of a selection of actual prudential and treasury management indicators and the actual results for investments and borrowings against forecasts.

3. TREASURY MANAGEMENT STRATEGY 2018/19

3.1 The Treasury Management Strategy covers two main areas:-

Capital:

- The capital plans and prudential indicators; and
- The minimum revenue provision (MRP) statement.

Treasury Management:

- The current position;
- Prudential indicators which limit the treasury risks and activities of the Commissioner;
- Prospects for interest rates;
- The borrowing strategy;
- The policy on borrowing in advance of need;
- Debt rescheduling;
- The investment strategy;
- The policy on creditworthiness; and
- The policy on using external service providers in relation to Treasury Management.

3.2 The above cover the requirements of the Local Government Act 2003, the CIPFA Prudential Code, Communities and Local Government's Minimum Revenue Provision (MRP) Guidance; the CIPFA Treasury Management Code and the Communities and Local Government's Investment Guidance.

3.3 The CIPFA Treasury Management Code requires the responsible officer (the Chief Finance Officer, OPCC) to ensure that anyone with responsibility for treasury management receives adequate training. The external treasury management supplier will provide suitable training during the year as appropriate.

3.4 From 1 April 2012 Capita Asset Services Limited has provided treasury management advice. However, it is recognised that responsibility for treasury management decisions remains with the Office of the Police & Crime Commissioner at all times and overdue reliance will not be placed upon one source of advice alone. Nevertheless, it is also recognised that there is value in employing external advisors in order to gain access to specialist skills and resources. During the current planning period Capita Asset Services has been sold to The Link Group. The services provided will not change under the new ownership.

3.5 CIPFA has recently reviewed and revised its Treasury Management Code of Practice and the Prudential Code. Changes are not wide ranging, most significant is the introduction of a capital strategy requirement which CIPFA acknowledges will be implemented by many organisations for the 2019/20 budget cycle due to the requirement being introduced late in the current budget planning cycle. Another notable change is the inclusion of requirements for non-treasury investments for example the purchase of property with a view to generating income. Such purchases could involve undertaking external borrowing to raise the cash to finance these purchases, or the use of existing cash balances. This type of income generation is not within usual policing business and the change is therefore unlikely to impact on the Commissioner.

3.6 CIPFA has also made some changes to prudential indicators, which are now incorporated into this report along with other revisions and amendments to the codes.

3.7 Under The Markets in Financial Instruments Directive (MiFID 2) regulations, the Financial Conduct Authority is obliged to treat all Local Authorities (which include Police and Crime Commissioners) as "retail clients" under European Union legislation. However, the regulator does offer the option to "opt up" to an Elective Professional Client if the authority meets certain criteria. There are no new "protections" for retail counterparties under MiFID II compared to the current MiFID regime. As such, opting up to elective professional client status does not result in losing any additional protections. By opting up, we will continue to maintain the status quo in terms of the investments that we currently use. If we chose not to opt up, we may lose access to MMFs and other pooled vehicles that we currently use, as they may not have been set up to deal with retail counterparties.

3.8 MiFID was introduced on 3rd January 2018. This only applies to regulated products which include Money Market Funds (MMF) and other investment funds, Certificate of Deposits, Gilts and Corporate Bonds. It does not apply to simple term deposits. After taking advice from the Commissioner's treasury advisors, the Commissioner has "opted up" to a professional client with the only MMF on his current counterparty list, Federated Investors. To opt up, the Commissioner demonstrated that cash balances are in excess of £10m and there is a professional resource within the organisation, equipped to be able to make daily treasury investment decisions.

4. CAPITAL EXPENDITURE PRUDENTIAL INDICATORS 2018-21

4.1 Capital expenditure

4.1.1 Capital expenditure plans are a key driver of treasury management activity. The funding of such plans impact on cash balances and borrowing requirements in the short and longer terms. The on-going consequences of these decisions have a direct impact on the annual revenue budget. As such, the following prudential indicators show the proposed capital expenditure plans, how they are to be funded, the impact on the organisation's finances and their affordability in terms of the impact on revenue budgets.

4.1.2 This prudential indicator is a summary of the Commissioner's capital expenditure plans, both those agreed previously, and those forming part of this budget cycle. These are based on actual and forecast cash spend as at Third Quarter Review rather than the full budgeted capital programme, as affordability is based on actual cash movement.

Table 1: Capital Expenditure

2017/18 Estimate £000	2018/19 Estimate £000	2019/20 Estimate £000	2020/21 Estimate £000
12,720	10,639	8,280	7,325

4.1.3 The next table shows how the above capital expenditure is to be financed. If there is a shortfall in available funds, the shortfall will be covered by additional borrowing. It is anticipated that additional borrowing will be required over the period.

Table 2: Capital Financing

2017/18 Estimate £000		2018/19 Estimate £000	2019/20 Estimate £000	2020/21 Estimate £000
12,720	Forecast Spend	10,639	8,280	7,325
	Financed by:			
647	General capital grants	647	400	300
240	Specific capital grants	0	0	0
5,771	Capital Receipts	4,305	371	1,835
4,266	Capital Reserves & Contributions	1,372	500	1,000
209	HQ IT Reserve	209	209	202
1,587	Borrowing requirement	4,106	6,800	3,988

4.2 Capital Financing Requirement (or borrowing needs)

4.2.1 The second prudential indicator is the Commissioner's Capital Financing Requirement (CFR). The CFR is simply the total historic outstanding capital expenditure which has not yet been financed either from revenue or capital funds. It is essentially a measure of borrowing need and any capital expenditure not financed in the above table will increase the CFR.

4.2.2 It should be noted that the Capital Financing Requirement increases during the period of the current MTFS, reflecting the increased borrowing requirement due to increased capital expenditure, and a reduction in other funding sources.

Table 3: Capital Financing Requirement (CFR)

2016/17 Actual £000	2017/18 Estimate £000		2018/19 Estimate £000	2019/20 Estimate £000	2020/21 Estimate £000
26,601	27,423	Borrowing Requirement	30,755	36,593	39,433
21,171	20,349	Other long term liabilities	19,441	18,447	17,380
47,771	**47,772**	**Total CFR**	**50,196**	**55,041**	**56,813**
	1	**Movement in CFR**	**2,424**	**4,845**	**1,772**

4.2.3 In addition to the capital expenditure borrowing requirements, the Capital Financing Requirement also includes other long-term financial liabilities relating to Constabulary Headquarters, and the finance lease for Charles Stewart House (purchased Sept 2016) for 2015/6 and 2016/17 only. Whilst these increase the CFR and therefore the Commissioner's borrowing requirement, these types of scheme include a borrowing facility and so the Commissioner is not required to borrow separately for these schemes.

4.2.4 As previously mentioned, the Capital Financing Requirement is reduced every year by the minimum revenue provision (MRP). The Commissioner is required by statute to set aside MRP each year for the repayment of external debt. Under amendment regulation 4(1) of the 2008 Regulations, the Commissioner is charged with a simple duty to set aside MRP which he considers to be prudent. Guidance has been issued which sets out recommendations on the interpretation of 'prudent' and the Commissioner is required to prepare an annual statement on how he proposes to calculate MRP. The 2018/19 annual statement is set out in the Annex.

4.3 Core Funds and Expected Investment Balances

4.3.1 The application of funds, (capital receipts, reserves etc.), to finance capital expenditure or other budget decisions to support the revenue budget will have an on-going impact on the cash available for investments unless resources are supplemented each year from new sources (asset sales etc.). Detailed below are the estimated year-end balances for reserves, and are based on actual and forecast cash spend as at Third Quarter Review rather than the full budgeted capital programme, as affordability is based on actual cash movement. The Capital Receipts and Unapplied Capital Grants reserves are restricted in their usage to funding capital expenditure or repaying debt and cannot be used for revenue purposes.

4.3.2

Table 4: Reserves

	31 March 2017 Actual £000	31 March 2018 Estimate £000	31 March 2019 Estimate £000	31 March 2020 Estimate £000	31 March 2021 Estimate £000
MTFS Reserve	1,466	1,136	1,136	1,136	1,136
LGPS Actuarial Deficit Payment Reserve	1,800	600	0	0	0
Redundancy Reserve	882	882	632	632	632
Carry Forward Reserve	205	0	0	0	0
	4,353	2,618	1,768	1,768	1,768
Capital Earmarked Reserves					
Capital Receipts	5,771	0	0	0	0
Revenue Reserve for Capital Expenditure	2,655	17	0	0	0
Unapplied Capital Grants	0	0	0	0	0
IT Reimbursement Reserve	0	0	0	0	0
	8,426	17	0	0	0
Revenue General Reserve					
General Fund	5,773	5,273	5,273	5,273	5,273
Total Reserves	**18,552**	**7,908**	**7,041**	**7,041**	**7,041**

Affordability Prudential Indicators

4.3.3 So far the Strategy has covered the control of overall capital expenditure plans and borrowing prudential indicators. Following on from these are the prudential indicators which assess the affordability of the capital expenditure plans. These provide an indication of the impact of the above capital expenditure plans and their financing proposals on the overall finances and precept (council tax). The Commissioner is requested to approve the following indicator:

Table 5: Ratio of financing costs to net revenue funding

2016/17 Actual	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate
0.91%	0.91%	0.92%	1.05%	1.25%

The estimates of financing costs include current commitments and the proposals included in the budget/medium-term financial strategy. The ratios have moved mainly due to the requirement to increase borrowing in order to finance the capital programme from 2018/19 onwards*.*

5. BORROWING

5.1 The capital expenditure plans set out in Section 4 provide details of the service activity of the Commissioner. A key function of treasury management is to ensure that the cash resources are organised in accordance with the relevant regulations and professional codes so that sufficient cash is available to meet service activity and the Commissioner's needs. This will involve both cashflow management and where capital expenditure plans require it, the arrangement of appropriate borrowing facilities. This Strategy covers the relevant treasury and prudential indicators, the current and projected debt positions and the Annual Investment Strategy.

Current Debt Position

5.1.1 The current debt position, as at 31 March 2017, with forward projections is summarised below. The table shows actual external debt against the underlying capital borrowing need highlighting any under or over borrowing.

Table 6: Debt Position

2016/17 Actual £000	2017/18 Estimate £000		2018/19 Estimate £000	2019/20 Estimate £000	2020/21 Estimate £000
16,778	16,778	External Debt as 1 April	18,365	21,566	28,366
0	1,587	Add/(less): net movement in year	3,201	6,800	3,988
21,946	21,171	Other Long term Liabilities	20,349	19,441	18,447
(775)	(821)	Add/(less): net movement in year	(909)	(993)	(1,068)
37,949	38,715	Gross Debt Position at 31 March	41,006	46,814	49,733
47,771	47,772	Less: Capital Financing Requirement	50,196	55,041	56,813
(9,822)	(9,057)	(Under) / Over Borrowing	(9,190)	(8,227)	(7,080)

5.1.2 Within the prudential indicators there are a number of key indicators to ensure that the Commissioner operates his activities within well-defined limits. One of these is that the Commissioner ensures that his gross debt does not, except in the short-term, exceed the total Capital Financing Requirement in the preceding year plus the estimates for any additional Capital Financing Requirement for 2018/19 and the following two financial years. This allows some flexibility for limited early borrowing for future plans but ensures that borrowing is not undertaken for revenue purposes.

5.1.3 The Chief Finance Officer confirms that the Commissioner complied with this prudential indicator in the current year and does not envisage any issues for the immediate future. This view takes into account current commitments, existing plans and the proposals included in the Medium Term Financial Strategy for 2018-21 to be approved by Management Board on 31st January 2018.

5.2 Treasury Indicators – limits to borrowing activities

5.2.1 There are two limits to borrowing, the operational boundary and the authorised limit for external debt. These are the current debt position as shown in 5.2 above plus the forecast requirement for external financing over the next three years.

5.2.2 **The operational boundary** is the limit which external debt and long-term liabilities is not normally expected to exceed. In most cases this would be a similar figure to the Capital Financing Requirement but may be higher or lower depending on the level of actual debt and repayment schedules. Temporary breach of the operational boundary is not in itself cause for concern but an indicator that such liabilities should be reviewed. If there was a sustained breach, (such as an increase in long-term borrowing), then this would need to be investigated and action taken.

5.2.3 The operational boundaries below are based on estimating the Commissioner's most likely level of borrowing and leasing each year. It includes long-term borrowing to fund capital expenditure plans, short-term borrowing for cashflow purposes and the impact of any finance leases but without the additional headroom of all future years' capital financing proposals which are included in the authorised limit.

Table 7: Operational Boundary

	2018/19 Estimate £000	**2019/20 Estimate £000**	**2020/21 Estimate £000**
Debt	37,470	40,214	42,878
Other long term liabilities	19,441	18,447	17,380
Total	56,911	58,661	60,257

5.2.4 As Table 7 shows, the Operational Boundary over the period 2018-21 is increasing because of the planned borrowing to support the capital programme. This is partially offset due to the amount set aside each year to reduce borrowing and financial liabilities known as MRP.

5.2.5 The **authorised limit for external debt** is a further key prudential indicator representing a control on the maximum level of borrowing. This represents a limit beyond which external debt and finance leases are prohibited and is set or revised by the Commissioner. It reflects the level of such debt which, while not desired, could be afforded in the short term but is not sustainable in the longer-term.

5.2.6 This is a statutory limit determined under section 3(1) of the Local Government Act 2003. The Government retains an option to control either the total of all local authorities' plans or those of any specific public body; although this power has yet to be exercised.

5.2.7 The Commissioner is requested to approve the following authorised limits.

Table 8: Authorised Limit

	2018/19 Estimate £000	**2019/20 Estimate £000**	**2020/21 Estimate £000**
Debt	39,470	42,214	44,878
Other long term liabilities	19,441	18,447	17,380
Total	58,911	60,661	62,257

5.3 Prospects for Interest Rates

	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
Bank Rate	0.50%	0.50%	0.50%	0.50%	0.75%	0.75%	0.75%	0.75%	1.00%	1.00%	1.00%	1.25%	1.25%	1.25%
5yr PWLB Rate	1.50%	1.60%	1.60%	1.70%	1.80%	1.80%	1.90%	1.90%	2.00%	2.10%	2.10%	2.20%	2.30%	2.30%
10yr PWLB View	2.10%	2.20%	2.30%	2.40%	2.40%	2.50%	2.60%	2.60%	2.70%	2.70%	2.80%	2.90%	2.90%	3.00%
25yr PWLB View	2.80%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.40%	3.50%	3.50%	3.60%	3.60%
50yr PWLB Rate	2.50%	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.20%	3.30%	3.30%	3.40%	3.40%

Source: Link Asset Services

5.3.1 As expected, the Monetary Policy Committee (MPC) delivered a 0.25% increase in Bank Rate at its meeting on 2 November. This removed the emergency cut in August 2016 after the EU referendum. The MPC also gave forward guidance that they expected to increase Bank rate only twice more by 0.25% by 2020 to end at 1.00%. The Link Asset Services forecast as above includes increases in Bank Rate of 0.25% in November 2018, November 2019 and August 2020.

5.3.2 The overall longer run trend is for gilt yields and PWLB rates to rise, albeit gently. It has long been expected, that at some point, there would be a more protracted move from bonds to equities after a historic long-term trend, over about the last 25 years, of falling bond yields. The action of central banks since the financial crash of 2008, in implementing substantial Quantitative Easing, added further impetus to this downward trend in bond yields and rising bond prices. Quantitative Easing has also directly led to a rise in equity values as investors searched for higher returns and took on riskier assets. The sharp rise in bond yields since the US Presidential election in November 2016 has called into question whether the previous trend may go into reverse, especially now the Fed. has taken the lead in reversing monetary policy by starting, in October 2017, a policy of not fully reinvesting proceeds from bonds that it holds when they mature.

5.3.3 Until 2015, monetary policy was focused on providing stimulus to economic growth but has since started to refocus on countering the threat of rising inflationary pressures as stronger economic growth becomes more firmly established. The Fed. has started raising interest rates and this trend is expected to continue during 2018 and 2019. These increases will make holding US bonds much less attractive and cause their prices to fall, and therefore bond yields to rise. Rising bond yields in the US are likely to exert some upward pressure on bond yields in the UK and other developed economies. However, the degree of that upward pressure is likely to be dampened by how strong or weak the prospects for economic growth and rising inflation are in each country, and on the degree of progress towards the reversal of monetary policy away from quantitative easing and other credit stimulus measures.

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

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

5.3.6 The overall balance of risks to economic recovery in the UK is probably to the downside, particularly with the current level of uncertainty over the final terms of Brexit.

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

- Bank of England monetary policy takes action too quickly over the next three years to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than we currently anticipate.
- Geopolitical risks, especially North Korea, but also in Europe and the Middle East, which could lead to increasing safe haven flows.
- A resurgence of the Eurozone sovereign debt crisis, possibly Italy, due to its high level of government debt, low rate of economic growth and vulnerable banking system.
- Weak capitalisation of some European banks.
- The result of the October 2017 Austrian general election has now resulted in a strongly anti-immigrant coalition government. In addition, the Czech ANO party became the largest party in the October 2017 general election on a platform of being strongly against EU migrant quotas and refugee policies. Both developments could provide major impetus to other, particularly former Communist bloc countries, to coalesce to create a major block to progress on EU integration and centralisation of EU policy. This, in turn, could spill over into impacting the Euro, EU financial policy and financial markets.
- Rising protectionism under President Trump
- A sharp Chinese downturn and its impact on emerging market countries

5.3.8 The potential for upside risks to current forecasts for UK gilt yields and PWLB rates, especially for longer term PWLB rates include: -

- The Bank of England is too slow in its pace and strength of increases in Bank Rate and, therefore, allows inflation pressures to build up too strongly within the UK economy, which then necessitates a later rapid series of increases in Bank Rate faster than we currently expect.
- UK inflation returning to sustained significantly higher levels causing an increase in the inflation premium inherent to gilt yields.
- The Fed causing a sudden shock in financial markets through misjudging the pace and strength of increases in its Fed. Funds Rate and in the pace and strength of reversal of Quantitative Easing, which then leads to a fundamental reassessment by investors of the relative risks of holding bonds, as opposed to equities. This could lead to a major flight from bonds to equities and a sharp increase in bond yields in the US, which could then spill over into impacting bond yields around the world.

Investment and borrowing rates

- Investment returns are likely to remain low during 2018/19 but to be on a gently rising trend over the next few years.
- Borrowing interest rates increased sharply after the result of the general election in June and then also after the September MPC meeting when financial markets reacted by

accelerating their expectations for the timing of Bank Rate increases. Apart from that, there has been little general trend in rates during the current financial year. The policy of avoiding new borrowing by running down spare cash balances has served well over the last few years. However, this needs to be carefully reviewed to avoid incurring higher borrowing costs in the future when authorities may not be able to avoid new borrowing to finance capital expenditure and/or the refinancing of maturing debt;

- There will remain a cost of carry to any new long-term borrowing that causes a temporary increase in cash balances as this position will, most likely, incur a revenue cost – the difference between borrowing costs and investment returns.

5.4 Borrowing Strategy

5.4.1 As shown in Table 6, the Commissioner is currently under-borrowed and forecast to remain so for the period covered by this Strategy. This means that the capital borrowing need (the Capital Financing Requirement), has not been fully funded with loan debt as cash supporting the Commissioner's reserves, balances and cash flow has been used as a temporary measure. This Strategy is appropriate for the current economic scenario and prudent given the limited investment return on surplus cash flow and counter-party risk are still issues that need to be considered. The risks associated with this Strategy are twofold, firstly the Commissioner could run out of cash should all reserves be utilised quickly at which point borrowing would be required and secondly, when the need to re-finance the internal borrowing arises, without careful planning, the Commissioner will be exposed to the prevailing interest rates at that time which may not be the most favourable.

5.4.2 Against this background and the identified risks, the Chief Finance Officer will monitor interest rates and adopt a pragmatic approach to changing circumstances, supported by advice from the external Treasury Management advisers.

5.4.3 A key aim of the borrowing strategy is to minimise the cost of the loan portfolio whilst ensuring that the obligation to repay the loans is spread out over a period of time. This reduces the impact of such loans on the revenue budget. The profile of the repayment of the debt portfolio is shown below at 5.5.3.

5.4.4 Where short term borrowing arrangements are required to support a temporary low general fund bank balance, the Commissioner will engage his Treasury Advisors to understand if there are any Local Authority counterparties available to lend from. The offer will then be considered and terms of loans agreed between the Principal Accountant and nominated officer from the lending organisation.

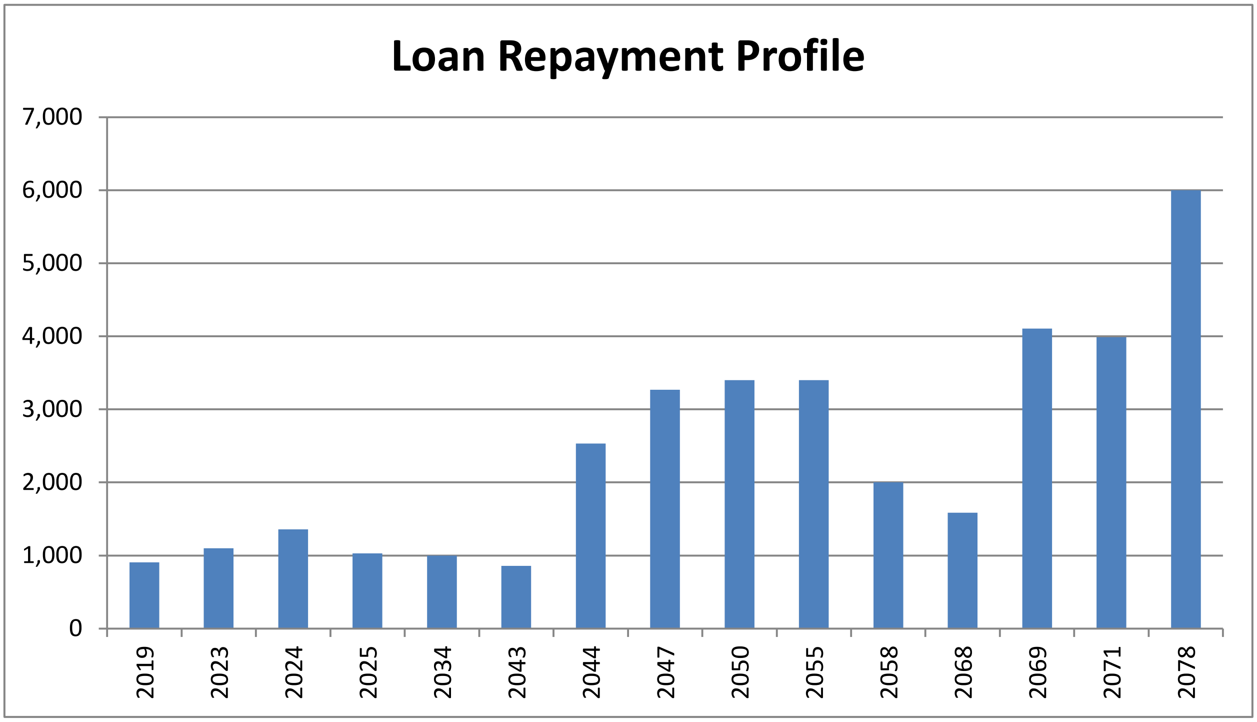
5.5 Debt Rescheduling

5.5.1 As short term borrowing rates will be considerably cheaper than longer term fixed interest rates, there may be potential opportunities to generate savings by switching from long term debt to short term debt. However these savings will need to be considered in the light of the current treasury position and size of the cost of debt repayments (premiums incurred).

5.5.2 The reasons for any rescheduling to take place will include:

- The generation of cash savings and/or discounted cash flow savings
- Helping to fulfil the treasury strategy
- Enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

5.5.3 Any potential rescheduling will be very carefully considered. A Table showing the profile of the debt portfolio is shown below:



5.5.4 The majority of the borrowing is on a fixed rate basis with the current overall weighted average of 4.31%. There is one loan held, (£6m), that is subject to semi-variable interest rates and has six monthly review periods when the bank can amend the rate or, the Commissioner can repay the loan if the new rate is deemed unacceptable. Any new loans taken out for future capital expenditure plans or the repayment of maturing debt will be subject to the rates applicable at that time. Any early repayment of debt would also be subject to the expense of early pay-back premiums.

5.5.5 Key sensitivities of the interest rate forecast are likely to be:

- If it were felt that there was a significant risk of a sharp rise in short and long-term rates, perhaps arising from a greater than expected increase in world economic activity or inflationary pressure, the debt portfolio would be reviewed with the potential action of increasing borrowing to cover the under borrowed position or future known commitments or repayments while rates were still relatively low; and

- If it were felt that there was a significant risk of a sharp fall in short and long-term interest rates due to a weakening of economic factors; then longer-term borrowing will be postponed until rates were deemed at their lowest and a review of current debt would be undertaken to ascertain the benefit of rescheduling to more competitive loans.

5.5.6 The introduction of different Public Works Loan Board (PWLB) rates on 1 November 2007 for new borrowing as opposed to early repayment of debt has meant that restructuring PWLB loans is now less attractive. However significant interest savings may still be achievable through the use of other market loans and this will be kept under review throughout the year and any changes reported to the Commissioner as part of the standard reporting cycle.

5.6 Treasury Management limits on activity

5.6.1 There are three debt-related treasury activity limits. Their purpose is to restrain borrowing activity within certain limits to manage risk and reduce the impact of adverse movement in interest rates. However, if these are set too restrictively they will impair the opportunity to reduce costs or maximise value for money. The Commissioner is requested to approve the following indicators and limits.

Table 9: Interest Rate Limits

	2018/19	**2019/20**	**2020/21**
	Upper	**Upper**	**Upper**
Limits on fixed interest rates based on net debt	100%	100%	100%
Limits on variable interest rates based on net debt	25%	25%	25%

Table 10: Maturity structure of fixed interest rate borrowing 2018/19

	Lower	**Upper**
Under 12 months	0%	15%
12 months to 2 years	0%	15%
2 years to 5 years	0%	25%
5 years to 10 years	0%	25%
10 years and above	50%	95%

6. ANNUAL INVESTMENT STRATEGY

6.1 Investment Policy

6.1.1 The Commissioner's investment policy has regard to the Communities and Local Government's Guidance on Local Government Investments and the CIPFA Treasury Management in Public Services Code of Practice and Cross Sectorial Guidance Notes (the CIPFA TM Code). The Commissioner's principal objectives for investments are security first, liquidity next and finally yield.

6.1.2 In accordance with the above guidance and codes and in order to minimise the risk to investments, the Commissioner sets out in 6.2 the minimum acceptable credit quality of counterparties for inclusion on the approved lending list. The creditworthiness methodology used to create the counterparty list fully accounts for the ratings, watches and outlooks published by all three ratings agencies (Fitch, Standard & Poor and Moodys) with a full understanding of what these reflect in the eyes of each agency. Using the Link ratings service, potential counterparties are monitored on a real-time basis with knowledge of any changes notified electronically as the agencies publish amendments.

6.1.3 Ratings are not used as a sole determinant of the quality of an institution. It is also important to continually assess and monitor the financial sector on both a local and international basis and the economic and political environments in each the counterparties operate. The assessment will also take into account information that reflects the opinion of the financial markets. To this end, the Commissioner will engage with the Treasury Management advisors to monitor market influences and pricing such as 'credit default swaps' where appropriate and available. This forms a fully integrated credit methodology provided by Link Asset Services in producing its colour codings which show the varying degrees of suggested creditworthiness.

6.1.4 Other information sources used will include the financial press; share price and other such information pertaining to the banking sector and other financial institutions in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.

6.1.5 The aim of the strategy is to generate a list of highly creditworthy counterparties which will also enable diversification and thus avoid any concentration of risk. The intention of this strategy is to provide security of investment and minimisation of risk.

6.1.6 Investment instruments identified for use in the financial year are listed in the table below. Counterparty limits will be set through the Commissioner's Treasury Management Practices and are currently at £10m per organisation/group.

Table 11: Approved Investment Instruments

Specified Investments (maturities up to one year) ▫ Bank & Building Societies Term Deposits ▫ Other Local Authority Term Deposits ▫ Debt Management Agency Deposit Facility
Non-Specified Investments (maturities over one year) ▫ Bank & Building Societies Term Deposits ▫ Other Local Authority Term Deposits
Other Non-Specified Investments ▫ Fixed term deposits with variable rates & maturities ▫ Money Market Funds

6.2 Creditworthiness Policy and Exposure to Risk

6.2.1 The Commissioner utilises the creditworthiness service provided by Link Asset Services as his Treasury Management advisers. This service employs a sophisticated modelling approach incorporating credit ratings from the three main credit rating agencies – Fitch, Moodys and Standard and Poor. The credit ratings of counterparties are supplemented with the following overlays:

- Credit watches and credit outlooks from credit rating agencies;
- Credit Default Swaps to give early warning of likely changes in credit ratings; and
- Sovereign ratings to select counterparties from only the most creditworthy countries.

6.2.2 This modelling approach combines credit ratings, credit watches and credit overlooks in a weighted scoring system which is then combined with an overlay of CDS spreads for which the end product is a series of colour coded bands which indicate the relative standing of counterparties. These colour codes are used by the Commissioner to determine the suggested duration of investments. The Commissioner will use counterparties within the following durational bands:

- Blue 1 year (only applies to nationalised or semi nationalised UK banks)
- Orange 1 year
- Red 6 months
- Green 100 days
- No Colour Not to be used

6.2.3 As this methodology uses a wide range of information beyond basic credit ratings, it ensures that no one source of information is given undue credence. All ratings and colour codes are monitored weekly via Link's credit listings and in-between via business press. The Commissioner is alerted to changes to any ratings via email from Link.

6.2.4 In response to changes to the ratings, the Commissioner approved the following action:

- If a downgrade results in the counterparty / investment scheme no longer meeting the Commissioner's minimum criteria, no further investments will be made and any current investments reviewed for potential movement.

6.2.5 Sole reliance will not be placed on the use of this external service. In addition to Link, the Commissioner's officers will also use market data and information, information on the Government's support for banks and the credit ratings of that support.

6.3 Country Limits

6.3.1 The Commissioner has determined that he will continue to use UK banks, and only use approved counterparties from countries outside of the UK with a minimum sovereign credit rating of AAA from Fitch (or equivalent). The list will be added to, or deducted from, should ratings change.

6.4 Investment Strategy

6.4.1 Investments will be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates.

6.4.2 The Commissioner would seek to maintain at all times a core liquid balance of £5m, and maintain a liquid balances vs longer term balances ratio of 50% - 50%.

6.4.3 For its cash flow generated balances, the Commissioner will seek to utilise its business reserve instant access and notice accounts, money market funds and short-dated deposits (overnight) in order to benefit from the compounding of interest.

6.4.4 Bank Rate is forecast to stay flat at 0.50% until quarter 4 2018 and not to rise above 1.25% by quarter 1 2021. Bank Rate forecasts for financial year ends (March) are:
2017/18 0.50%
2018/19 0.75%
2019/20 1.00%
2020/21 1.25%

6.5 End of Year Investment Report

6.5.1 At the end of the financial year, the Chief Finance Officer will report on the Commissioner’s investment activity as part of the Annual Treasury Report.

7. MINIMUM REVENUE PROVISION (MRP) STATEMENT

7.1 All local authorities have a legal requirement to set aside money to cover the repayment of debt. The amount of MRP charged needs to be a prudent amount. The broad aim of a prudent provision is to ensure that debt is repaid over a period that is either, reasonably commensurate with that over which the associated capital expenditure provides benefits, or in the case of borrowing supported by formula grant, reasonably commensurate with the period implicit in the determination of the grant.

7.2 As a result of the proposed capital programme, around 45% of the 2017/18 Capital Financing Requirement will relate to the more historic debt liability that will continue to be charged at the rate of 4% in accordance with the Guidance (Capital Financing and Accounting, England Amendment Regulations 2008). The remaining amount will, under delegated powers (known as prudential borrowing), be subject to MRP under option 3 of the Guidance, which will be charged over a period which is reasonably commensurate with the estimated useful life applicable to the nature of expenditure, using the equal annual instalment method. For example, capital expenditure on a new building will be related to the estimated life of that building.

7.3 The use of this option for certain schemes/expenditures will also result in a nil MRP charge until the year after that in which all expenditures on the scheme, project or other item of capital expenditure have been fully accrued under proper accounting practices, regardless of the extent of such expenditure that has not been accrued at the end of the previous financial year. Items of capital expenditure will only be divided up when considering schemes in this, or any other context, in cases where two or more major components have substantially different useful economic lives. Assets will not be transferred to the asset register and non-current assets account until complete, in accordance with standard accounting principles.

7.4 Estimated life periods will be determined under delegated powers. To the extent that expenditures are not on the creation of an asset and are of a type that are subject to estimated life periods that are referred to in the Guidance, these periods will generally be adopted by the Commissioner. However, in the case of long-term debtors arising from loans or other types of capital expenditure made by the Commissioner which will be repaid under separate arrangements, no MRP will be made. The Commissioner is satisfied that a prudent provision will be achieved after exclusion of these capital expenditures.

7.5 In view of the variety of different types of capital expenditure incurred by the Commissioner, which is not in all cases capable of being related to an individual asset e.g., capitalising revenue items; asset lives will be assessed on the basis which most reasonably reflects the anticipated period of benefit that arises from the expenditure. Also, whatever type of expenditure is involved, it will be grouped together in a manner which reflects the nature of the main component of expenditure and will only be divided up in cases where there are two or more major components having substantially different useful economic lives.

7.6 The policy will be reviewed on an annual basis. If it is ever proposed to vary the terms of the original statement during any year, approval from the Commissioner will be required.