North Wales Police and Crime Commissioner

Capital Strategy Report Executive Summary 2020-21 to 2024-25

1. The enclosed draft report meets the requirements of CIPFA's Treasury Management in the Public Services' Code of practice which the Police and Crime Commissioner is legally required to follow. The main document, the Capital Strategy, brings together the Capital Programme, Revenue Provision for Borrowing, Treasury Management and Investment Strategy and the Treasury Indicators; with the intention of simplifying what is a highly technical area. However, the report is still highly technical, this covering report will briefly explain the overall purpose and highlight what the Police and Crime Commissioner is being asked to agree in adopting the Strategy. The Strategy and its constituent elements have to be agreed annually and Police and Crime Commissioner. The purpose of presenting this report to the Audit Committee is for discussion and comment prior to submission to the Police and Crime Commissioner.

2. There are no fundamental changes to the strategy this year.

3. The overall purpose of the Capital Strategy is for the Police and Crime Commissioner to:

- Formally agree the Capital Programme (Appendix A)
- Agree which method is adopted for the repayment of debt (Minimum Revenue Provision) Appendix B.
- Provide the Strategy framework for Treasury Management that is borrowing for Capital Expenditure and Investing Balance (Appendix C)
- Agree the Treasury Indicators that set limits on the level of borrowing as well as the type and counterparties for investments (Appendix C)

4. The Capital Programme has been agreed by the Chief Constable and the Police and Crime Commissioner as part of the planning cycle feeding into the Medium Term Financial Plan (MTFP). Additional short term requirements for the uplift in officer numbers have been included for short term assets (Fleet, Equipment and IT) and flexibility has been built in for longer term assets (Estates) to deal with changing requirements (Table 1 and Appendix A)

5. A primary and critical requirement is that the Capital Programme is affordable within the resources available, this is the case by a combination of external funding, own resources (in year budget or reserves) or debt. The programme is affordable and the split in financing is shown in Table 2.

6. Debt must be repaid; this is done through the revenue budget by means of minimum revenue provision. There is statutory guidance in relation to how the debt is serviced.

Historical debt (pre 2008) is re paid based on the rules that were in place at the time of 4% reducing balance. For Capital expenditure incurred after 31.3.2008 the MRP is determined by charging the expenditure over the useful life of the asset. Table 3 summarised the cost and details are contained in Appendix C.

7. The total debt relating to Capital is called the Capital Financing Requirement (CFR). Movement in the CFR is summarised in Table 4. The total CFR increases from a projected £31m at 31.3.2020 to £36.1m at 31.3.2025.

8. One source of internal funding is Capital Receipts, these are the proceeds from the sales of assets, and these can only be used to fund capital expenditure. The projected movement in Capital Receipts are shown in Table 5.

9. The Treasury Management strategy relates to the management of cash balances in terms of borrowing and investments. Priority is given to security of funds followed by liquidity and then yield. Section 3 of the Capital Strategy summarises the TM strategy with the details in Appendix C.

10. In terms of borrowing a balance is struck between external and internal borrowing and long and short term borrowing. This is slightly complicated by funding income not being received consistently through the year with one large payment being made each July. Short Term loans have lower interest rates but this can change over time. £10m long term loans were secured during 2019-20 at a low interest rate of 1.25%.

11. Investments are tightly controlled minimising risk as far as possible by managing counter parties through credit and other ratings, and limiting the amount and length of investments.

12. Table 10 shown the total financing costs as a % of net revenue budget, this reduced from 3.29% to 3.06% from 2020-21 to 2024-25.

13. Professionally qualified and specifically trained staff have responsibility for making decisions relating to capital expenditure, investments and borrowing. In addition to this professional advisors are retained to provide advice and guidance in these technical areas.

Capital Strategy Report 2020/21

1. Introduction

1.1. This capital strategy report gives a high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of local public services along with an overview of how associated risk is managed and the implications for future financial sustainability. It has been written in an accessible style to enhance understanding of these sometimes technical areas.

1.2. Decisions made this year on capital and treasury management will have financial consequences for the Police and Crime Commissioner for many years into the future. They are therefore subject to both a national regulatory framework and to local policy framework, summarised in this report.

2. Capital Expenditure and Financing

2.1. Capital expenditure is where the Police and Crime Commissioner spends money on assets, such as property or vehicles, that will be used for more than one year. In local government this also includes spending on assets owned by other bodies.

2.2. The draft Capital Programme was presented to the Strategic Executive Board (SEB) on 21st January 2020 and agreed subject to the final ratification of this Capital Strategy. In addition to this, expenditure relating to the purchase of vehicles for the officer uplift project has been included, following receipt of additional revenue funding. Also the Home Office Capital grant has been reduced by 74% which equates to a reduction of £0.339m in external funding, which has necessitated a corresponding increase from revenue funding. The Police and Crime Commissioner is planning capital expenditure as summarised below, with details as shown in **Appendix A**:

Table 1: Prudential Indicator: Estimates of Capital Expenditure in £ millions

	2018/19 actual	2019/20 forecast	2020/21 budget	2021/22 budget	2022/23 budget	2023/24 budget	2024/25 budget
	£m	£m	£m	£m	£m	£m	£m
Total Capital Expenditure	11.3	9.2	9.9	7.9	6.5	7.5	3.9

2.3. **Governance**: The Capital Programme has been fully revised as part of the 2020/21 planning cycle. The previous Capital Programme, implemented since 2013-14, has come to its conclusion. By the end of 2019-20 the following will have been achieved:

- **Estates -** 4 major new facilities in Llangefni, Llandudno, Llay and Wrexham Town Centre, plus 20+ refurbishments and relocations
- **Fleet** - Continuation of the Vehicle Replacement Programme
- **IT -** Upgraded Network, Servers, Desk Tops, Mobile devices and the replacement of the Control Room Technology systems.

2.4. The Forces assets and infrastructure need continued investment in order to ensure efficient and modern working practices. Strategies for the Estates, IT and Fleet were developed last year and a new Capital Programme set out. However, since the Programme was set the announcement of the uplift in officer numbers has been made. The initial allocation is for an additional 62, but this could increase to 200, plus support staff. This will mean that the Estates provision will need to be revised once the full requirements are known.

2.5. The refurbishment of Pwllheli is due to start this financial year and finish next year. The re location of the Forces Vehicle Workshop, currently rented, is due to start next year subject to final Business Case. Other work in the HQ complex and the Firearms base are planned for 2020-21.

2.6. Substantial investment is required for IT infrastructure. This is being directed by the Digital Transformation Programme Board. The personal issue of tablets and similar devices to operational officers and staff will enable mobility and the use of the National Enablement Programme in terms of the latest software available. Project Mandates have been provided in each area; the detailed cases and business benefits are being developed. The Programme also includes the replacement of Body Worn Video equipment. Additional investment of £4.056m has been estimated for the period 2019-20 to 2024-25.

2.7. The programme is affordable and funded from a combination of grants, reserves, direct revenue contribution and borrowing. The overall strategy is to minimise borrowing and maximise the amounts budgeted in revenue by use of direct revenue contribution and capital receipts, which in turn minimises interest payments. The planned financing of the above expenditure is as follows:

Table 2: Capital financing in £ millions

	2018/19 actual	**2019/20 forecast**	**2020/21 budget**	**2021/22 budget**	**2022/23 budget**	**2023/24 budget**	**2024/25 budget**
	£m	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**
External sources	0.5	0.5	0.1	0.1	0.1	0.1	0.1
Own resources	5.0	6.3	4.2	2.7	2.1	3.4	2.5
Debt	5.8	2.4	5.6	5.0	4.3	4.0	1.3
TOTAL	**11.3**	**9.2**	**9.9**	**7.9**	**6.5**	**7.5**	**3.9**

2.8. Debt is only a temporary source of finance, since loans and leases must be repaid, and this is therefore replaced over time by other financing, usually from revenue which is known as minimum revenue provision (MRP). Alternatively, proceeds from selling capital assets (known as capital receipts) may be used to replace debt finance. Planned MRP is as follows:

Table 3: Replacement of debt finance in £ millions

	2018/19 actual	2019/20 forecast	2020/21 budget	2021/22 budget	2022/23 budget	2023/24 budget	2024/25 budget
	£m	£m	£m	£m	£m	£m	£m
Budgeted MRP (Own resources)	2.1	2.3	2.7	3.1	3.1	3.1	3.1

- The Police and Crime Commissioner's full minimum revenue provision statement is shown in **Appendix B** to this report.

2.9. The Police and Crime Commissioner's cumulative outstanding amount of debt finance is measured by the capital financing requirement (CFR). This increases with new debt-financed capital expenditure and reduces with MRP and capital receipts used to replace debt. The CFR is expected to increase by £2.9m during 2020/21, and then increase a further £2.2m net over the following 5 years. Based on the above figures for expenditure and financing, the Police and Crime Commissioner's estimated CFR is as follows:

Table 4: Prudential Indicator: Estimates of Capital Financing Requirement in £ millions

	31.3.19 actual	31.3.20 forecast	31.3.21 forecast	31.3.22 forecast	31.3.23 forecast	31.3.24 forecast	31.3.25 forecast
	£m	£m	£m	£m	£m	£m	£m
Total CFR	**30.9**	**31.0**	**33.9**	**35.9**	**37.1**	**37.9**	**36.1**

2.10. Accounting for leased assets will change from 2021/22 onwards, which could result in an estimated increase of up to £1million on the CFR. This is a technical change which will not affect the actual cost of borrowing. A full assessment will be undertaken during the next financial year.

2.11. **Asset management:** To ensure that capital assets continue to be of long-term use, the Police and Crime Commissioner has an asset management strategy in place. This is detailed in the Estates Strategy and the Information Technology Strategy.

2.12. **Asset disposals:** When a capital asset is no longer needed, it may be sold so that the proceeds, known as capital receipts, can be spent on new assets or to repay debt. The Police and Crime Commissioner is not anticipating to receive any significant capital receipts in the coming financial years.

Table 5: Capital receipts receivable in £ millions

	2018/19 actual	2019/20 forecast	2020/21 budget	2021/22 budget	2022/23 budget	2023/24 budget	2024/25 budget
	£m	£m	£m	£m	£m	£m	£m
Opening	**1.5**	**0.0**	**2.0**	**2.5**	**2.1**	**2.2**	**1.3**

balance							
Receipts	**0.2**	**2.5**	**0.7**	**0.0**	**0.2**	**0.5**	**0.4**
Budgeted use	**1.7**	**0.5**	**0.2**	**0.4**	**0.1**	**1.4**	**0.5**
Balance	**0.0**	**2.0**	**2.5**	**2.1**	**2.2**	**1.3**	**1.2**

3. Treasury Management

3.1. Treasury management is concerned with keeping sufficient but not excessive cash available to meet the Police and Crime Commissioner's spending needs, while managing the risks involved. Surplus cash is invested until required, while a shortage of cash will be met by borrowing, to avoid excessive credit balances or overdrafts in the bank current account. The Police and Crime Commissioner is typically cash rich in the short-term as revenue income is received before it is spent, but cash poor in the long-term as capital expenditure is incurred before being financed. The revenue cash surpluses are offset against capital cash shortfalls to reduce overall borrowing.

3.2. The Treasury Management Strategy (Appendix C) sets out the parameters under which the Treasury Management activities are governed and monitored. These are based on prioritising security first, liquidity second and yield last. This does reduce potential investment income but minimises the risk of losing money through riskier investments. The below summarises the main points of the Treasury Management Strategy.

3.3. **Borrowing strategy:** The Police and Crime Commissioner's main objectives when borrowing are to achieve a low but certain cost of finance while retaining flexibility should plans change in future. These objectives are often conflicting, and the Police and Crime Commissioner therefore seeks to strike a balance between cheap short-term loans (currently available at around 0.75%) and long-term fixed rate loans where the future cost is known but higher (currently 2.0 to 3.0%).

3.4. The Borrowing Strategy is also balanced by revenue cash available being used rather than borrowing, known as internal borrowing. Internal borrowing has been used extensively over recent years generating savings in interest charges per year and reducing risk by not investing cash. However, use of reserves to fund Capital has reduced the available amounts to internally borrow. Another factor to consider is that the Police and Crime Commissioner's income is not constant during the year; this is due to a Pension Grant of around £20m being paid in one lump sum each July. This has resulted in short term borrowing being required for 6 to 8 months of the year. However following consultation with our Treasury Management Consultants, and close monitoring of the PWLB interest rates, it was agreed to take out two long term loans (20 years) of £5m each, at an all-time low interest rate (1.25%) in August and October 2019 (prior to the Government's decision to increase all PWLB borrowing rates by 1%).

3.5. Projected levels of the Police and Crime Commissioner's total outstanding debt (which comprises borrowing, PFI liabilities, leases are shown below, compared with the capital financing requirement (see above).

Table 6: Prudential Indicator: Gross Debt and the Capital Financing Requirement in £ millions

	2018/19 actual	2019/20 forecast	2020/21 budget	2021/22 budget	2022/23 budget	2023/24 budget	2024/25 budget
	£m	£m	£m	£m	£m	£m	£m
PFI	10.7	9.9	9.1	8.2	7.3	6.2	5.1
Long Term Loans	0.7	9.9	9.4	8.9	8.4	7.9	7.4
Short Term loans	16.0	4.0	5.5	10.1	13.0	16.6	17.1
Debt (incl. PFI & leases)	27.4	23.8	24.0	27.2	28.6	30.7	29.6
Capital Financing Requirement	30.9	31.0	33.9	35.9	37.1	37.9	36.1

3.6. Statutory guidance is that debt should remain below the capital financing requirement, except in the short-term. As can be seen from table 6, the Police and Crime Commissioner expects to comply with this in the medium term.

3.7. **Liability benchmark:** To compare the Police and Crime Commissioner's actual borrowing against an alternative strategy, a liability benchmark has been calculated showing the lowest risk level of borrowing. This assumes that cash and investment balances are kept to a minimum level of £10m at each year-end. This benchmark is currently £9m and is forecast to rise to £24m over the next three years.

Table 7: Borrowing and the Liability Benchmark in £ millions

	31.3.2019 actual	31.3.2020 forecast	31.3.2021 budget	31.3.2022 budget	31.3.2023 budget	31.3.2024 budget	31.3.2025 budget
	£m	£m	£m	£m	£m	£m	£m
Outstanding borrowing	16.7	13.9	14.9	19.0	21.3	24.5	24.5
Liability benchmark	9.3	9.1	14.9	19.0	21.3	24.5	24.5

The table shows that the Police and Crime Commissioner plans to remain borrowed in line with its liability benchmark in order to minimise risk.

3.8. **Affordable borrowing limit:** The Police and Crime Commissioner is legally obliged to set an affordable borrowing limit (also termed the authorised limit for external debt) each year and to keep it under review. In line with statutory guidance, a lower "operational boundary" is also set as a warning level should debt approach the limit.

Table 8: Prudential Indicators: Authorised limit and operational boundary for external debt in £m

	2019/20 limit	***2020/21 limit***	***2021/22 limit***	***2022/23 limit***	***2023/24 limit***	***2024/25 limit***
	£m	***£m***	***£m***	***£m***	***£m***	***£m***
Authorised limit – borrowing	*22.4*	*25.8*	*28.7*	*30.8*	*32.7*	*32.0*
Authorised limit – PFI and leases *	*9.9*	*9.1*	*8.2*	*7.3*	*6.2*	*5.1*
Authorised limit – total external debt	***32.3***	***34.9***	***36.9***	***38.1***	***38.9***	***37.1***
Operational boundary – borrowing	*20.4*	*23.8*	*26.7*	*28.8*	*30.7*	*30.0*
Operational boundary – PFI and leases *	*9.9*	*9.1*	*8.2*	*7.3*	*6.2*	*5.1*
Operational boundary – total external debt	***30.3***	***32.9***	***34.9***	***36.1***	***36.9***	***35.1***

3.9. **Treasury investment strategy:** Treasury investments arise from receiving cash before it is paid out again. Investments made for service reasons or for pure financial gain are not generally considered to be part of treasury management.

3.10. The Police and Crime Commissioner's policy on treasury investments is to prioritise security and liquidity over yield - that is to focus on minimising risk rather than maximising returns. Cash that is likely to be spent in the near term is invested securely, for example with the government, other local authorities or selected high-quality banks, to minimise the risk of loss. Money that will be held for longer terms is invested more widely, including in bonds, shares and property, to balance the risk of loss against the risk of receiving returns below inflation. Both near-term and longer-term investments may be held in pooled funds, where an external fund manager makes decisions on which particular investments to buy and the Police and Crime Commissioner may request its money back at short notice.

Table 9: Treasury management investments in £millions

	31.3.2019 actual	**31.3.2020 forecast**	**31.3.2021 budget**	**31.3.2022 budget**	**31.3.2023 budget**	**31.3.2024 budget**
	£m	**£m**	**£m**	**£m**	**£m**	**£m**
Near-term	17.5	10.9	10.0	10.0	10.0	10.0

investments						
Longer-term investments	0.0	0.0	0.0	0.0	0.0	0.0
TOTAL	**17.5**	**10.9**	**10.0**	**10.0**	**10.0**	**10.0**

3.11. **Risk management:** The effective management and control of risk are prime objectives of the Police and Crime Commissioner's treasury management activities. The treasury management strategy therefore sets out various indicators and limits to constrain the risk of unexpected losses and details the extent to which financial derivatives may be used to manage treasury risks.

3.12. **Governance:** Decisions on treasury management investment and borrowing are made daily and are therefore delegated to the Head of Finance and staff, who must act in line with the treasury management strategy approved by the Police and Crime Commissioner and Joint Audit Committee (JAC). End of year and half year reports on treasury management activity are presented to SEB and JAC. The JAC is responsible for scrutinising treasury management decisions.

3.13. **Liabilities:** In addition to debt detailed above, the Police and Crime Commissioner is committed to making future payments to cover its pension fund costs. Police Officers' pension scheme is an unfunded scheme which is underwritten by the Government, and the liabilities stand at £1,793m as at 31.3.19. The cost to the Police and Crime Commissioner is the employer contribution rate, which was increased from 24.2% to 31% on 1 April 2019, and which had to be funded from the revenue budget. The deficit on the Staff Pension fund stood at £85m as at 31.3.19, this is also managed through the contribution rate which will be set at 19% from 1 April 2020. The Police and Crime Commissioner has also set aside £1.2m as a provision to cover risks of insurance claims and employment cases. The Police and Crime Commissioner is also at risk of having to pay for claims lodged with the Central London Employment Tribunal. These risks have been recognised as Contingent Liabilities in the Statement of Accounts, but The Police and Crime Commissioner has not put aside any money because the claims are subject to appeal, and there is uncertainty regarding remedy and quantum.

3.14. **Governance (liabilities):** Decisions on incurring new discretional liabilities are taken by the Chief Officer Team in consultation with the Police and Crime Commissioner and his Chief Finance Officer. The risk of liabilities crystallising and requiring payment is monitored by Corporate Finance and reported to Strategic Management Board (SMB) and SEB as necessary. Details of contingent liabilities as at the 31 March will be included in the Statement of Accounts.

4. Revenue Budget Implications

4.1. Although capital expenditure is not charged directly to the revenue budget, interest payable on loans, MRP for reducing the CFR and direct revenue contribution to capital are charged to revenue, offset by any investment income receivable. The net annual charge is known as financing costs; this is compared to the net revenue stream i.e. the amount funded from Police and Crime Commissioner's Council Tax and general government grants.

Table 10: Prudential Indicator: Proportion of financing costs to net revenue stream

	2018/19 actual	**2019/20 forecast**	**2020/21 budget**	**2021/22 budget**	**2022/23 budget**	**2023/24 budget**	**2024/25 budget**
Financing costs (£m)	5.5	5.5	5.4	5.4	5.4	5.4	5.5
Proportion of net revenue stream	3.73%	3.59%	3.29%	3.23%	3.13%	3.11%	3.06%

4.2. **Sustainability:** Due to the very long-term nature of capital expenditure and financing, the revenue budget implications of expenditure incurred in the next few years will extend for up to 40 years into the future. The Police and Crime Commissioner's Chief Finance Officer and the Director of Finance and Resources are satisfied that the proposed capital programme is prudent, affordable and sustainable as there are revenue streams or reserves in place to fund the Programme as set out. It is likely that additional resources will need to be budgeted for future investments beyond the current Programme.

5. <u>Knowledge and Skills</u>

5.1. The Police and Crime Commissioner employs professionally qualified and experienced staff in senior positions with responsibility for making capital expenditure, borrowing and investment decisions. Training is provided to all staff involved in making capital expenditure, borrowing and investment decisions.

5.2. Where the Police and Crime Commissioner's staff do not have the knowledge and skills required, use is made of external advisers and consultants that are specialists in their field. The Police and Crime Commissioner currently employs Arlingclose Limited as treasury management advisers, Wilks Head and Eve as property consultants and BDO as tax consultants. This approach is more cost effective than employing such staff directly, and ensures that the Police and Crime Commissioner has access to knowledge and skills commensurate with its risk appetite.

APPENDIX A

DRAFT CAPITAL PROGRAMME		2020-21	2021-22	2022-23	2023-24	2024-25
		£'000	£'000	£'000	£'000	£'000
Estate Programme						
Sustainability Improvements		100	100	100	100	100
Pwllheli PS		780				
FHQ Complex + Canteen		257				
VCC / Vehicle Workshop		1,545	1,325			
Western Estate Area		475				
Estate Review 2		1,084	2,570	3,379	3,791	1,333
Firearms Base works		288				
Total Building Works		**4,529**	**3,995**	**3,479**	**3,891**	**1,433**
Vehicles and Other Equipment						
Vehicle Purchase Replacement Programme		1,731	1,731	1,731	1,731	1,731
PSU Vehicles (Revenue Stream replacemnt programme)				555		
Intoxilators x 3		30				
ANPR replacement		470				
Total Vehicles and Other Equipment		**2,231**	**1,731**	**2,286**	**1,731**	**1,731**
Information Technology and Communication Equipment						
Desk Top Replacement (Replacement Programme)		1,202	300	750	750	750
Mobile app / Life X Deployment		471				
Server Replacement			700			
Business Systems Servers (Replacement Programme)			145			
Mobile data devices		570			460	
Airwave replacement ESN			1,000			
DFU Server replacement		20			270	
Wifi		250				
Single on line Home (Digital Public Contact)		40				
Digital Intelligence & Investigation		193				
ICAD Upgrade (Command and Control Upgrade)		400				
Body Worn Video					400	
Total Information Technology and Communication		**3,146**	**2,145**	**750**	**1,880**	**750**
Total Capital Expenditure		**9,906**	**7,871**	**6,515**	**7,502**	**3,914**
Funding						
Home Office Grant		123	123	123	123	123
Revenue Contribution		2,413	2,286	2,008	2,008	2,008
Earmarked Reserves		1,608	0	0	0	0
Capital Receipts		155	377	100	1,420	475
Borrowing for Estates		4,141	3,895	3,379	3,141	958
Borrowing for replacement programme		1,466	1,190	905	810	350
Total Funding		**9,906**	**7,871**	**6,515**	**7,502**	**3,914**

Minimum Revenue Provision (for debt repayment) Annual Statement 2020/21

Where the Police and Crime Commissioner finances capital expenditure by debt, it 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 Police and Crime Commissioner to have regard to Welsh Government's *Guidance on Minimum Revenue Provision* (the WG Guidance) most recently issued in 2018.

The broad aim of the WG Guidance is to ensure that capital expenditure is financed 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 WG Guidance requires the Police and Crime Commissioner to approve an Annual MRP Statement each year and recommends a number of options for calculating a prudent amount of MRP. The following statement only incorporates options recommended in the Guidance:

- For capital expenditure incurred before 1st April 2008, MRP will be determined as 4% of the capital financing requirement in respect of that expenditure. *(Option 2)*

- For capital expenditure incurred after 31st March 2008, MRP will be determined by charging the expenditure over the expected useful life of the relevant asset in equal instalments, starting in the year after the asset becomes operational. MRP on purchases of freehold land will be charged over 50 years. MRP on expenditure not related to fixed assets but which has been capitalised by regulation or direction will be charged over 20 years. *(Option 3)*

- For assets acquired by leases or the Private Finance Initiative, MRP will be determined as being equal to the element of the rent or charge that goes to write down the balance sheet liability.

Capital expenditure incurred during 2020/21 will not be subject to a MRP charge until 2021/22.

Based on the Police and Crime Commissioner's latest estimate of its capital financing requirement (CFR) on 31st March 2020, the budget for MRP has been set as follows:

	31.03.2020 Estimated CFR £m	2020/21 Estimated MRP £
Capital expenditure before 01.04.2008	7.9	0.3
Capital expenditure after 31.03.2008	13.2	1.6
Leases and Private Finance Initiative	9.9	0.8
Total General Fund CFR	**31.0**	**2.7**

Appendix C

Draft Treasury Management Strategy Statement and Investment Strategy 2020/21

1. Introduction

1.1. Treasury management is the management of the Police and Crime Commissioner's cash flows, borrowing and investments, and the associated risks. The Police and Crime Commissioner has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of financial risk are therefore central to the Police and Crime Commissioner's prudent financial management.

1.2. Treasury risk management at the Police and Crime Commissioner is conducted within the framework of the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice 2017 Edition* (the CIPFA Code) which requires the Police and Crime Commissioner to approve a treasury management strategy before the start of each financial year. In addition, the Welsh Government (WG) issued revised Guidance on Local Authority Investments in March 2010 that requires the Police and Crime Commissioner to approve an investment strategy before the start of each financial year. This report fulfils the Police and Crime Commissioner's legal obligation under the *Local Government Act 2003* to have regard to both the CIPFA Code and the WG Guidance.

1.3. Revised strategy: In accordance with the WG Guidance, the Police and Crime 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, in the Police and Crime Commissioner's capital programme or in the level of its investment balance.

2. External Context

2.1. **Economic background:** The UK's progress negotiating its exit from the European Union, together with its future trading arrangements, will continue to be a major influence on the Police and Crime Commissioner's treasury management strategy for 2020/21.

2.2. UK Consumer Price Inflation (CPI) for September registered 1.7% year on year, unchanged from the previous month. Core inflation, which excludes the more volatile components, rose to 1.7% from 1.5% in August. The most recent labour market data for the three months to August 2019 showed the unemployment rate ticked back up to 3.9% while the employment rate was 75.9%, just below recent record-breaking highs. The headline 3-month average annual growth rate for pay was 3.8% in August as wages continue to rise steadily. In real terms, after adjusting for inflation, pay growth increased 1.9%.

2.3. GDP growth rose by 0.3% in the third quarter of 2019 from -0.2% in the previous three months with the annual rate falling further below its trend rate to 1.0% from 1.2%.

Services and construction added positively to growth, by 0.6% and 0.4% respectively, while production was flat and agriculture recorded a fall of 0.2%. Looking ahead, the Bank of England's Monetary Policy Report (formerly the Quarterly Inflation Report) forecasts economic growth to pick up during 2020 as Brexit-related uncertainties dissipate and provide a boost to business investment helping GDP reach 1.6% in Q4 2020, 1.8% in Q4 2021 and 2.1% in Q4 2022.

2.4. The Bank of England maintained Bank Rate to 0.75% in November following a 7-2 vote by the Monetary Policy Committee. Despite keeping rates on hold, MPC members did confirm that if Brexit uncertainty drags on or global growth fails to recover, they are prepared to cut interest rates as required. Moreover, the downward revisions to some of the growth projections in the Monetary Policy Report suggest the Committee may now be less convinced of the need to increase rates even if there is a Brexit deal.

2.5. Growth in Europe remains soft, driven by a weakening German economy which saw GDP fall -0.1% in Q2 and is expected to slip into a technical recession in Q3. Euro zone inflation was 0.8% year on year in September, well below the European Central Bank's target of 'below, but close to 2%' and leading to the central bank holding its main interest rate at 0% while cutting the deposit facility rate to -0.5%. In addition to maintaining interest rates at ultra-low levels, the ECB announced it would recommence its quantitative easing programme from November.

2.6. In the US, the Federal Reserve began easing monetary policy again in 2019 as a pre-emptive strike against slowing global and US economic growth on the back on of the ongoing trade war with China. At its last meeting the Fed cut rates to the range of 1.50-1.75% and financial markets expect further loosening of monetary policy in 2020. US GDP growth slowed to 1.9% annualised in Q3 from 2.0% in Q2.

2.7. **Credit outlook:** Credit conditions for larger UK banks have remained relatively benign over the past year. The UK's departure from the European Union was delayed three times in 2019 and while there remains some concern over a global economic slowdown, this has yet to manifest in any credit issues for banks. Meanwhile, the post financial crisis banking reform is now largely complete, with the new ringfenced banks embedded in the market.

2.8. Challenger banks hit the news headlines in 2019 with Metro Bank and TSB Bank both suffering adverse publicity and falling customer numbers.

2.9. Looking forward, the potential for a "no-deal" Brexit and/or a global recession remain the major risks facing banks and building societies in 2020/21 and a cautious approach to bank deposits remains advisable.

2.10. **Interest rate forecast:** The Police and Crime Commissioner's treasury management adviser Arlingclose is forecasting that Bank Rate will remain at 0.75% until the end of 2022. The risks to this forecast are deemed to be significantly weighted to the downside, particularly given the upcoming general election, the need for greater clarity on Brexit and the continuing global economic slowdown. The Bank of England, having previously indicated interest rates may need to rise if a Brexit agreement was reached, stated in its November Monetary Policy Report and its Bank Rate decision (7-2 vote to hold rates) that the MPC now believe this is less likely even in the event of a deal.

2.11. Gilt yields have risen but remain at low levels and only some very modest upward movement from current levels are expected based on Arlingclose's interest rate projections. The central case is for 10-year and 20-year gilt yields to rise to around 1.00% and 1.40% respectively over the time horizon, with broadly balanced risks to both the upside and downside. However, short-term volatility arising from both economic and political events over the period is a near certainty.

2.12. A more detailed economic and interest rate forecast provided by Arlingclose is attached at **Appendix C.1.**

3. <u>Local Context</u>

3.1. On 31st March 2020, the Police and Crime Commissioner is expected to hold £13.9m of borrowing and £10.9m of treasury investments. This is set out in further detail at **Appendix C.2**. Forecast changes in these sums are shown in the balance sheet analysis in table 1 below.

Table 1: Balance sheet summary and forecast

	31.3.19 Actual £m	31.3.20 Estimate £m	31.3.21 Forecast £m	31.3.22 Forecast £m	31.3.23 Forecast £m	31.3.24 Forecast £m	31.3.25 Forecast £m
General Fund CFR	**30.9**	**31.0**	**33.9**	**35.9**	**37.1**	**37.9**	**36.1**
Less: Other debt liabilities *	-10.6	-9.9	-9.1	-8.2	-7.3	-6.2	-5.1
Loans CFR	**20.3**	**21.1**	**24.9**	**27.8**	**29.8**	**31.7**	**31.0**
Less: External borrowing (long term)**	-0.7	-9.9	-9.4	-8.9	-8.4	-7.9	-7.4
Less: External borrowing (short term)**	-16.0	-4.0	0.0	0.0	0.0	0.0	0.0
Internal borrowing	**3.6**	**7.2**	**15.5**	**18.9**	**21.5**	**23.8**	**23.6**
Less: Usable reserves	-23.6	-22.2	-20.2	-19.0	-18.7	-17.4	-16.7
Plus: Working capital	2.6	0.2	0.2	0.2	0.2	0.2	0.2
New borrowing / (Investments)	**-17.4**	**-14.8**	**-4.5**	**0.1**	**3.0**	**6.6**	**7.1**

* leases and PFI liabilities that form part of the Police and Crime Commissioner's total debt
** shows only loans to which the Police and Crime Commissioner is committed and excludes optional refinancing

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

3.3. The Police and Crime Commissioner has an increasing CFR due to the capital programme, but minimal investments and will therefore be required to borrow up to

£7m over the forecast period in order to maintain a positive level of liquidity (see also 3.5 below).

3.4. CIPFA's *Prudential Code for Capital Finance in Local Authorities* recommends that the Police and Crime Commissioner's total debt should be lower than its highest forecast CFR over the next three years. Table 1 shows that the Police and Crime Commissioner expects to comply with this recommendation during 2020/21.

3.5. **Liability benchmark:** To compare the Council's actual borrowing against an alternative strategy, a liability benchmark has been calculated showing the minimum amount of borrowing required to keep investments at a minimum liquidity level. This assumes the same forecasts as table 1 above, but that cash and investment balances are kept to a minimum level of **£10m** to maintain sufficient liquidity but minimise credit risk.

Table 2: Liability benchmark

	31.3.19 Actual £m	**31.3.20 Estimate £m**	**31.3.21 Forecast £m**	**31.3.22 Forecast £m**	**31.3.23 Forecast £m**	**31.3.24 Forecast £m**	**31.3.25 Forecast £m**
Loans CFR	**20.3**	**21.1**	**24.9**	**27.8**	**29.8**	**31.7**	**31.0**
Less: Usable reserves	-23.6	-22.2	-20.2	-19.0	-18.7	-17.4	-16.7
Plus: Working capital	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Net Borrowing Requirement / (Investments)	**-3.1**	**-0.9**	**4.9**	**9.0**	**11.3**	**14.5**	**14.5**
Minimum investments	10.0	10.0	10.0	10.0	10.0	10.0	10.0
Liability Benchmark	**6.9**	**9.1**	**14.9**	**19.0**	**21.3**	**24.5**	**24.5**

3.6. Following on from the medium-term forecasts in table 2 above, the Police and Crime Commissioner plans to remain borrowed in line with its liability benchmark in order to minimise risk.

4. Borrowing Strategy

4.1. The Police and Crime Commissioner currently holds £10 million of loans, a decrease of £6.7 million on the previous year, as part of its strategy for funding previous years' capital programmes. The balance sheet forecast in table 1 indicates that the Police and Crime Commissioner has a projected cash and investment balance of £4.5million as at 31 March 2020. In order to achieve a minimum cash and investment balance of £10million, there may be a need to borrow up to £5.5million (£14.9million liability benchmark less £9.4million already borrowed). The Police and Crime Commissioner may also borrow to pre-fund future years' requirements, providing this does not exceed the authorised limit for borrowing of £36.9 million.

4.2. **Objectives:** The Police and Crime 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 Police and Crime Commissioner's long-term plans change is a secondary objective.

4.3. **Strategy:** Given the significant cuts to public expenditure and in particular to local government funding, the Police and Crime Commissioner's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. With short-term interest rates currently much lower than long-term rates, it is likely to be more cost effective in the short-term to either use internal resources, or to borrow short-term loans instead.

4.4. By doing so, the Police and Crime Commissioner is able to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk. The benefits of internal and 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 Police and Crime Commissioner with this 'cost of carry' and breakeven analysis. Its output may determine whether the Police and Crime Commissioner borrows additional sums at long-term fixed rates in 2020/21 with a view to keeping future interest costs low, even if this causes additional cost in the short-term.

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

4.6. Alternatively, the Police and Crime 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.

4.7. In addition, the Police and Crime Commissioner may borrow short-term loans to cover projected cash flow shortages.

4.8. **Sources of borrowing:** The approved sources of long-term and short-term borrowing are:

- UK Debt Management Office (previously Public Works Loan Board (PWLB)) and any successor body
- 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 Gwynedd Pension Fund)
- capital market bond investors

4.9. **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
- Private Finance Initiative
- sale and leaseback

4.10. **Short-term and variable rate loans**: These loans leave the Police and Crime Commissioner exposed to the risk of short-term interest rate rises and are therefore subject to the interest rate exposure limits in the treasury management indicators below.

4.11. **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 Police and Crime 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.

5. Investment Strategy

5.1. The Police and Crime Commissioner holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. In the past 12 months, the Police and Crime Commissioner's investment balance has ranged between £31.2million and £10 million, and similar levels are expected to be maintained in the forthcoming year.

5.2. **Objectives:** Both the CIPFA Code and the WG Guidance require the Police and Crime Commissioner to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Police and Crime 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 Police and Crime 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.

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

5.4. **Strategy:** Although there is increasing risk and very low returns from short-term unsecured bank investments, the Police and Crime Commissioner aims to continue to invest in short term bank investments during 2020/21. This is in concurrence with the internal borrowing strategy, minimising the amounts invested (and associated risk) and maximising yield (by reducing interest payments).

5.5. **Business models:** Under the new IFRS 9 standard, the accounting for certain investments depends on the Police and Crime Commissioner's "business model" for managing them. The Police and Crime Commissioner aims to achieve value from its internally managed treasury investments by a business model of collecting the contractual cash flows and therefore, where other criteria are also met, these investments will continue to be accounted for at amortised cost.

5.6. **Approved counterparties:** The Police and Crime Commissioner may invest its surplus funds with any of the counterparty types in table 3 below, subject to the cash limits (per counterparty) and the time limits as recommended by our Treasury Management advisors.

Table 3: Approved investment counterparties and limits

Credit Rating	Banks Unsecured	Banks Secured	Government	Corporates
UK Govt	n/a	n/a	£ Unlimited	n/a
AAA	£4m	£7m	£7m	£7m
AA+	£4m	£7m	£7m	£7m
AA	£4m	£7m	£7m	£7m
AA-	£4m	£7m	£7m	£7m
A+	£4m	£7m	£7m	£7m
A	£4m	£7m	£7m	£7m
A-	£4m	£7m	£7m	£7m

HSBC[1]	£10m	£10m	n/a	n/a
Unrated Local Authorities	n/a	n/a	£7m	n/a
Pooled Funds	£4m per fund			

1 These are the Commissioner's bankers and are currently rated AA- by the credit rating agencies.

This table must be read in conjunction with the notes below

5.7. **Credit rating:** Investment limits are set by reference to the lowest published long-term credit rating from a selection of external rating agencies. Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used. However, investment decisions are never made solely based on credit ratings, and all other relevant factors including external advice will be taken into account.

5.8. **Banks unsecured:** Accounts, deposits, certificates of deposit and senior unsecured bonds with banks and building societies, other than multilateral development banks. These investments are subject to the risk of credit loss via a bail-in should the regulator determine that the bank is failing or likely to fail. See below for arrangements relating to operational bank accounts.

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

5.10. **Government:** Loans, bonds and bills issued or guaranteed by national governments, regional and local authorities and multilateral development banks. These investments are not subject to bail-in, and there is generally a lower risk of insolvency, although they are not zero risk. Investments with the UK Central Government may be made in unlimited amounts for up to 50 years.

5.11. Corporates: Loans, bonds and commercial paper issued by companies other than banks and registered providers. These investments are not subject to bail-in, but are exposed to the risk of the company going insolvent. Loans to unrated companies will only be made as part of a diversified pool in order to spread the risk widely.

5.12. **Operational bank accounts:** The Police and Crime Commissioner may incur operational exposures, for example though current accounts, collection accounts and merchant acquiring services, to any UK bank with credit ratings no lower than BBB- and with assets greater than £25 billion. These are not classed as investments, but are still subject to the risk of a bank bail-in, and balances will therefore be kept below £10 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 Police and Crime Commissioner maintaining operational continuity.

5.13. **Risk assessment and credit ratings**: Credit ratings are obtained and monitored by the Police and Crime 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.

5.14. 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.

5.15. **Other information on the security of investments**: The Police and Crime 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 Police and Crime 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.

5.16. When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008 and 2011, this is not generally reflected in credit ratings, but can be seen in other market measures. In these circumstances, the Police and Crime 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 Police and Crime Commissioner's cash balances, then the surplus will be deposited with the UK Government via the Debt Management Office or invested in government treasury bills for example, or with other local authorities. This will cause a reduction in the level of investment income earned but will protect the principal sum invested.

5.17. Investment limits: The Police and Crime Commissioner's revenue reserves available to cover investment losses are forecast to be £22 million on 31st March 2020. In order to manage investment losses, risk limits have been set (see table 3 above). 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, investments in brokers' nominee accounts, foreign countries and industry sectors as below. Investments in pooled funds and multilateral development banks do not count against the limit for any single foreign country, since the risk is diversified over many countries.

5.18. Liquidity management: The Police and Crime Commissioner uses purpose-built cash flow forecasting methods to determine the maximum period for which funds may prudently be committed. The forecast is compiled on a prudent basis to minimise the risk of the Police and Crime Commissioner being forced to borrow on unfavourable terms to meet its financial commitments. Limits on long-term investments are set by reference to the Police and Crime Commissioner's medium-term financial plan and cash flow forecast.

6. Treasury Management Indicators

6.1. The Police and Crime Commissioner measures and manages its exposures to treasury management risks using the following indicators.

6.2. **Security:** The Police and Crime Commissioner has set a minimum credit rating of A- for investments

Credit risk indicator	**Target**
Minimum credit rating for investment	A-

6.3. **Liquidity:** The Police and Crime Commissioner has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments within a rolling twelve month period.

Liquidity risk indicator	**Target**
Total cash available within 12 months	£10m

6.4. **Interest rate exposures**: This indicator is set to control the Police and Crime Commissioner's exposure to interest rate risk. The upper limits on the one-year revenue impact of a 1% rise or fall in interest rates will be:

Interest rate risk indicator	**Limit**
Upper limit on one-year revenue impact of a 1% rise in interest rates	£50,000
Upper limit on one-year revenue impact of a 1% fall in interest rates	£50,000

The impact of a change in interest rates is calculated on the assumption that maturing loans and investments will be replaced at current rates.

6.5. **Maturity structure of borrowing:** This indicator is set to control the Police and Crime Commissioner's exposure to refinancing risk. The upper and lower limits on the maturity structure of borrowing will be:

Refinancing rate risk indicator	**Upper limit**	**Lower limit**
Under 12 months	100%	0%
12 months and within 24 months	100%	0%
24 months and within 5 years	100%	0%
5 years and within 10 years	100%	0%

10 years and above	100%	0%

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

6.6. **Principal sums invested for periods longer than a year:** The purpose of this indicator is to control the Police and Crime 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:

Price risk indicator	**2020/21**	**2021/22**	**2022/23**
Limit on principal invested beyond year end	£5m	£3m	£1m

7. Related Matters

7.1. The CIPFA Code requires the Police and Crime Commissioner to include the following in its treasury management strategy.

7.2. **Financial Derivatives:** In the absence of any explicit legal power to do so, the Police and Crime Commissioner will not use standalone financial derivatives (such as swaps, forwards, futures and options). Derivatives 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 line with the overall treasury risk management strategy.

7.3. **Markets in Financial Instruments Directive**: The Police and Crime Commissioner has opted up to professional client status with its providers of financial services, including advisers, banks, brokers and fund managers, allowing it access to a greater range of services but without the greater regulatory protections afforded to individuals and small companies. Given the size and range of the Police and Crime Commissioner's treasury management activities, the Chief Financial Officer believes this to be the most appropriate status.

7.4. Government Guidance: Further matters required by the WG Guidance are included in **Appendix C.3.**

8. **Financial Implications**

8.1. The budget for investment income in 2020/21 is £0.1 million, based on an average investment portfolio of £10 million at an interest rate of 1%. The budget for debt interest paid in 2020/21 is £0.172 million, based on an average debt portfolio of £14 million at an average interest rate of 1.23%. If actual levels of investments and borrowing, or actual interest rates, differ from those forecast, performance against budget will be correspondingly different.

9. Other Options Considered

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

Alternative	Impact on income and expenditure	Impact on risk management
Invest in a narrower range of counterparties and/or for shorter times	Interest income will be lower	Lower chance of losses from credit related defaults, but any such losses may be greater
Invest in a wider range of counterparties and/or for longer times	Interest income will be higher	Increased risk of losses from credit related defaults, but any such losses may be smaller
Borrow additional sums at long-term fixed interest rates	Debt interest costs will rise; this is unlikely to be offset by higher investment 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 C.1

Arlingclose Economic & Interest Rate Forecast November 2019

Underlying assumptions:

- The global economy is entering a period of slower growth in response to political issues, primarily the trade policy stance of the US. The UK economy has displayed a marked slowdown in growth due to both Brexit uncertainty and the downturn in global activity. In response, global and UK interest rate expectations have eased.

- Some positivity on the trade negotiations between China and the US has prompted worst case economic scenarios to be pared back. However, information is limited, and upbeat expectations have been wrong before.

- Brexit has been delayed until 31 January 2020. While the General Election has maintained economic and political uncertainty, the opinion polls suggest the Conservative position in parliament may be strengthened, which reduces the chance of Brexit being further frustrated. A key concern is the limited transitionary period following a January 2020 exit date, which will maintain and create additional uncertainty over the next few years.

- UK economic growth has stalled despite Q3 2019 GDP of 0.3%. Monthly figures indicate growth waned as the quarter progressed and survey data suggest falling household and business confidence. Both main political parties have promised substantial fiscal easing, which should help support growth.

- While the potential for divergent paths for UK monetary policy remain in the event of the General Election result, the weaker external environment severely limits potential upside movement in Bank Rate, while the slowing UK economy will place pressure on the MPC to loosen monetary policy. Indeed, two MPC members voted for an immediate cut in November 2019.

- Inflation is running below target at 1.7%. While the tight labour market risks medium-term domestically-driven inflationary pressure, slower global growth should reduce the prospect of externally driven pressure, although political turmoil could push up oil prices.

- Central bank actions and geopolitical risks will continue to produce significant volatility in financial markets, including bond markets.

Forecast:

- Although we have maintained our Bank Rate forecast at 0.75% for the foreseeable future, there are substantial risks to this forecast, dependant on General Election outcomes and the evolution of the global economy.

- Arlingclose judges that the risks are weighted to the downside.

- Gilt yields have risen but remain low due to the soft UK and global economic outlooks. US monetary policy and UK government spending will be key influences alongside UK monetary policy.

- We expect gilt yields to remain at relatively low levels for the foreseeable future and judge the risks to be broadly balanced.

	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Average
Official Bank Rate														
Upside risk	0.00	0.00	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	**0.21**
Arlingclose Central Case	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	0.75
Downside risk	-0.50	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	**-0.73**
3-month money market rate														
Upside risk	0.10	0.10	0.25	0.25	0.25	0.25	0.25	0.25	0.30	0.30	0.30	0.30	0.30	**0.25**
Arlingclose Central Case	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	0.75
Downside risk	-0.50	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	**-0.73**
1yr money market rate														
Upside risk	0.10	0.20	0.20	0.20	0.20	0.20	0.20	0.25	0.30	0.30	0.30	0.30	0.30	**0.23**
Arlingclose Central Case	**0.85**	**0.85**	**0.85**	**0.85**	**0.85**	**0.85**	**0.85**	**0.85**	**0.85**	**0.85**	**0.85**	**0.85**	**0.85**	0.85
Downside risk	-0.30	-0.50	-0.55	-0.65	-0.65	-0.65	-0.65	-0.65	-0.65	-0.65	-0.65	-0.65	-0.65	**-0.60**
5yr gilt yield														
Upside risk	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	0.45	0.45	0.45	**0.37**
Arlingclose Central Case	**0.50**	**0.50**	**0.50**	**0.55**	**0.60**	**0.60**	**0.60**	**0.60**	**0.60**	**0.60**	**0.60**	**0.60**	**0.60**	0.57
Downside risk	-0.35	-0.50	-0.50	-0.55	-0.60	-0.60	-0.60	-0.60	-0.60	-0.60	-0.60	-0.60	-0.60	**-0.56**
10yr gilt yield														
Upside risk	0.30	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	0.40	0.45	0.45	**0.37**
Arlingclose Central Case	**0.75**	**0.75**	**0.80**	**0.80**	**0.85**	**0.85**	**0.90**	**0.90**	**0.95**	**0.95**	**1.00**	**1.00**	**1.00**	0.88
Downside risk	-0.40	-0.40	-0.40	-0.40	-0.45	-0.45	-0.45	-0.45	-0.50	-0.50	-0.50	-0.50	-0.50	**-0.45**
20yr gilt yield														
Upside risk	0.30	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	0.40	0.45	0.45	**0.37**
Arlingclose Central Case	**1.20**	**1.20**	**1.25**	**1.25**	**1.25**	**1.30**	**1.30**	**1.30**	**1.35**	**1.35**	**1.35**	**1.40**	**1.40**	1.30
Downside risk	-0.40	-0.40	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.50	-0.50	**-0.45**
50yr gilt yield														
Upside risk	0.30	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	0.40	0.45	0.45	**0.37**
Arlingclose Central Case	**1.20**	**1.20**	**1.25**	**1.25**	**1.25**	**1.30**	**1.30**	**1.30**	**1.35**	**1.35**	**1.35**	**1.40**	**1.40**	1.30
Downside risk	-0.40	-0.40	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.50	-0.50	**-0.45**

PWLB Certainty Rate (Maturity Loans) = Gilt yield + 1.80%
PWLB Local Infrastructure Rate (Maturity Loans) = Gilt yield + 0.60%

Appendix C.2

Existing Investment & Debt Portfolio Position

	31/03/20 **Actual Portfolio (with estimated movements up to the end of year and subject to end of year checks)** **£m**
External Borrowing:	
Fixed Rate – Debt Office	9.9
Fixed Rate – Local Government	4.0
Total External Borrowing	**13.9**
Other Long Term Liabilities:	
- PFI	9.9
- Finance Leases	0.0
Total Gross External Debt	**23.8**
Investments:	
Managed in-house	
- Short-term monies (Deposits/ monies on call /MMFs)	-10.9
- Long-term investments	0.0
Managed externally	
- By Fund Managers	0.0
Total Investments	**-10.9**
Net Debt	**12.9**

Appendix C.3

Additional requirements of Welsh Government Guidance

Specified investments: The WG Guidance defines specified investments as those:

- denominated in pound sterling,
- due to be repaid within 12 months of arrangement,
- not defined as capital expenditure by legislation, and
- invested with one of:
  - the UK Government,
  - a UK local Police and Crime Commissioner, parish council or community council, or
  - a body or investment scheme of "high credit quality".

The Police and Crime Commissioner defines "high credit quality" organisations and securities as those having a credit rating of A- or higher that are domiciled in the UK or a foreign country with a sovereign rating of AA+ or higher. For money market funds and other pooled funds "high credit quality" is defined as those having a credit rating of A- or higher.

Non-specified investments: Any investment not meeting the definition of a specified investment is classed as non-specified. The Police and Crime Commissioner does not intend to make any investments denominated in foreign currencies nor any defined as capital expenditure. Non-specified investments will therefore be limited to long-term investments, i.e. those that are due to mature 12 months or longer from the date of arrangement and limited to no more than £5m.

Investment training: The needs of the Police and Crime Commissioner's treasury management staff for training in investment management are assessed on a regular basis, and additionally when the responsibilities of individual members of staff change.

Staff regularly attend training courses, seminars and conferences provided by Arlingclose and CIPFA. Relevant staff are also encouraged to study professional qualifications from CIPFA, the Association of Corporate Treasurers and other appropriate organisations.

Investment advisers: The Police and Crime Commissioner has appointed Arlingclose Limited as treasury management advisers and receives specific advice on investment, debt and capital finance issues. The quality of this service is controlled by regular strategy meetings, review of data provided and professional judgement.

Investment of money borrowed in advance of need: The Police and Crime Commissioner may, from time to time, borrow in advance of need, where this is expected to provide the best long-term value for money. Since amounts borrowed will be invested until spent, the Police and Crime Commissioner is aware that it will be exposed to the risk of loss of the borrowed sums, and the risk that investment and borrowing interest rates may change in the intervening period.

These risks will be managed as part of the Police and Crime Commissioner's overall management of its treasury risks.

The total amount borrowed will not exceed the authorised borrowing limit of £36.9 million. The maximum period between borrowing and expenditure is expected to be two years, although the Police and Crime Commissioner is not required to link particular loans with particular items of expenditure.