JOINT AUDIT COMMITTEE

30 March 2021

Capital Strategy Report Executive Summary 2020-21 to 2025-26

Report by the Chief Constable's and Police and Crime Commissioner's Chief Finance Officers

1. The enclosed 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, as 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 by the Police and Crime Commissioner. The purpose of presenting this report to the Joint 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 (see minor change in point 12 below).

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 via the Minimum Revenue Provision Statement (MRP) (Appendix B)
- Provide the strategy framework for Treasury Management which encompasses borrowing for capital expenditure and investing residual balances (Appendix C)
- Agree the Treasury Indicators that set limits on the levels of borrowing, as well as limits on the types of 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). A further exercise has since been undertaken to re-assess the phasing of individual capital projects which has resulted in a change in the timing of the projects but not the overall costs (Table 1 and Appendix A).

5. A primary and critical requirement is that the Capital Programme is affordable within the resources available - this is achieved 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 the minimum revenue provision (MRP). There is statutory guidance in relation to how the debt is serviced. Historical debt (pre 2008) is repaid 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 summarises the cost, and further 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 £30.5m at 31.3.2021 to £40.5m at 31.3.2026.

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 received each July (Appendix C, Graph 1). Short Term loans have lower interest rates but this can change over time.

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. The previous Strategy set a minimum liquidity level of £10m – this has been expanded for practical purposes to also allow a lower operational limit of £7.5 million for a maximum of 14 days to avoid unnecessary short term borrowing (see Appendix C, paragraph 6.3)

13. Table 10 shows the total financing costs as a percentage of net revenue budget, this is projected to increase from 3.50% to 3.95% from 2021-22 to 2025-26.

14. 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 2021/22

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 members' 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 includes spending on assets owned by other bodies, and loans and grants to other bodies enabling them to buy assets.

2.2. The draft Capital Programme was presented to the Strategic Executive Board (SEB) on 21st January 2021 as part of the Medium Term Financial Plan, and agreed subject to the final ratification of this Capital Strategy. A further exercise has been undertaken to re-assess the phasing of individual capital projects which has resulted in a change in the timing of the projects but not the overall costs. 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

	2019/20 actual	**2020/21 forecast**	**2021/22 budget**	**2022/23 budget**	**2023/24 budget**	**2024/25 budget**	**2025/26 budget**
	£m	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**
Total Capital Expenditure	6.4	6.1	15.1	17.8	5.0	5.6	5.4

2.3. **Governance**: The Police and Crime Commissioner's assets and infrastructure need continual investment in order to ensure an efficient and modern working environment. Strategies for the Estates, IT and Fleet were developed last year and a new Capital Programme agreed in 2020-21. The implementation of Operation Uplift; reviewing the requirements as part of the planning cycle; and the COVID recovery plan, has resulted in revisions to the planned Programme. COVID has resulted in some re phasing of the Programme due to delays. Major projects such as ESN (Emergency Services Network) and the Command and Control System upgrade have also been under review. The summary of the changes in each area are:

- Revised Estates Programme £17.3m – an increase of £0.427m from last year's programme
- Revised Fleet Programme £8.2m – a reduction of £0.341m per annum of direct revenue funding
- Revised IT Programme £21.1m -
  - Known future major requirements – Command and Control (£2.5m), ESN (£7.2m+£0.9m), IT Sourcing (£1.0m)
  - Future replacements of laptops/2 in 1's/Desktops (£2.9m), Body Worn Video (£1.0m), Life X (£1.1m) and other smaller projects.

2.4. All capital expenditure must be financed, either from external sources (government grants and other contributions), the Police and Crime Commissioner's own resources (revenue, reserves and capital receipts) or debt (borrowing, leasing and Private Finance Initiative). The planned financing of the above expenditure is as follows:

Table 2: Capital financing in £ millions

	2019/20 actual	**2020/21 forecast**	**2021/22 budget**	**2022/23 budget**	**2023/24 budget**	**2024/25 budget**	**2025/26 budget**
	£m	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**
External sources	0.5	0.1	0.1	0.1	0.1	0.1	0.1
Capital resources	0.3	0.0	0.2	0.1	0.3	0.7	0.1
Revenue resources	3.7	3.3	7.4	4.2	2.1	2.1	2.0
Debt	1.9	2.7	7.4	13.4	2.5	2.7	3.2
TOTAL	**6.4**	**6.1**	**15.1**	**17.8**	**5.0**	**5.6**	**5.4**

2.5. 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 repayments are as follows:

Table 3: Replacement of debt finance in £ millions

	2019/20 actual	2020/21 forecast	2021/22 budget	2022/23 budget	2023/24 budget	2024/25 budget	2025/26 budget
	£m	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**
Budgeted MRP (Own resources)	2.4	2.6	2.8	3.1	4.4	4.3	4.6

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

2.6. 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 £4.6m during 2021/22. 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

	31.3.2020 actual	31.3.2021 forecast	31.3.2022 budget	31.3.2023 budget	31.3.2024 budget	31.3.2025 budget	31.3.2026 budget
	£m	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**
Total CFR	30.4	30.5	35.1	45.4	43.5	41.9	40.5

2.7. **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.

2.8. **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

	2019/20 actual	2020/21 forecast	2021/22 budget	2022/23 budget	2023/24 budget	2024/25 budget	2025/26 budget
	£m	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**
Opening balance	0.0	0.1	2.0	2.8	2.9	3.0	2.7
Receipts	0.4	2.0	1.0	0.2	0.5	0.4	0.0
Budgeted use	0.3	0.1	0.2	0.1	0.4	0.7	0.0
Balance	**0.1**	**2.0**	**2.8**	**2.9**	**3.0**	**2.7**	**2.7**

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 0.10%) and long-term fixed rate loans where the future cost is known but higher (currently 1.5 to 2.5%).

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 £25m being received in one lump sum each July.

3.5. Projected levels of the Police and Crime Commissioner's total outstanding debt (which comprises borrowing, PFI liabilities, and 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

	31.3.2020 actual	**31.3.2021 forecast**	**31.3.2022 budget**	**31.3.2023 budget**	**31.3.2024 budget**	**31.3.2025 budget**	**31.3.2026 budget**
	£m	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**
Debt (incl. PFI & leases)	24.8	18.4	17.1	15.7	14.1	12.5	10.7
Capital Financing Requirement	30.4	30.5	35.1	45.4	43.5	41.9	40.5

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.

Table 7: Borrowing and the Liability Benchmark in £ millions

	31.3.2020 actual	**31.3.2021 forecast**	**31.3.2022 budget**	**31.3.2023 budget**	**31.3.2024 budget**	**31.3.2025 budget**	**31.3.2026 budget**
	£m	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**
Outstanding borrowing	14.9	9.4	8.9	8.4	7.9	7.4	6.9
Liability benchmark	9.4	-1.3	11.9	26.5	28.6	29.0	29.5

The outstanding borrowing in the table above shows the current level of committed borrowing, and the liability benchmark is an indicator of the maximum we may need to borrow in order to keep cash and investment balances above £10m. The actual level of borrowing will depend on cashflow throughout the year and will be somewhere between the two levels outlined above.

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 £millions

	2020/21 limit	2021/22 limit	2022/23 limit	2023/24 limit	2024/25 limit	2025/26 limit
	£m	**£m**	**£m**	**£m**	**£m**	**£m**
Authorised limit – borrowing	25.8	27.9	39.1	38.3	37.8	37.6
Authorised limit – PFI and leases	9.1	8.2	7.3	6.2	5.1	3.9
Authorised limit – total external debt	**34.9**	**36.1**	**46.4**	**44.5**	**42.9**	**41.5**
Operational boundary – borrowing	23.8	25.9	37.1	36.3	35.8	35.6
Operational boundary – PFI and leases	9.1	8.2	7.3	6.2	5.1	3.9
Operational boundary – total external debt	**32.9**	**34.1**	**44.4**	**42.5**	**40.9**	**39.5**

Further details on borrowing are in the treasury management strategy.

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

	31.3.2020 actual	31.3.2021 forecast	31.3.2022 budget	31.3.2023 budget	31.3.2024 budget	31.3.2025 budget	31.3.2026 budget
	£m	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**
Near-term investments	15.5	20.6	10.0	10.0	10.0	10.0	10.0
Longer-term investments	0.0	0.0	0.0	0.0	0.0	0.0	0.0
TOTAL	**15.5**	**20.6**	**10.0**	**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 £1,793.0m as at 31.3.20. The cost to the Police and Crime Commissioner is the employer contribution rate, which is currently 31%. The deficit on the Staff Pension fund stood at £85.0m as at 31.3.20, this is also managed through the contribution rate which is currently set at 19%. 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.

- **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 the Strategic Management Board (SMB) and SEB as necessary. Details of contingent liabilities as at 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 contributions 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 the Police and Crime Commissioner's Council Tax and general government grants.

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

	2019/20 actual	2020/21 forecast	2021/22 budget	2022/23 budget	2023/24 budget	2024/25 budget	2025/26 budget
	£m	£m	£m	£m	£m	£m	£m
Financing costs (£m)	6.1	6.3	6.1	6.1	7.3	7.2	7.5
Proportion of net revenue stream (%)	3.95%	3.87%	3.50%	3.43%	4.03%	3.92%	3.95%

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 50 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. Knowledge and Skills

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

Description	2020-21 Revised Estimate	2021-22 Est	2022-23 Est	2023-24 Est	2024-25 Est	2025-26 Est	Total Project Costs (inc pre 20-21)
	£000	£000	£000	£000	£000	£000	£000
Estate Programme							
Retentions, Consultancy and QS	**25**						**25**
Sustainability Improvements	**0**	202	100	100	100	100	**602**
Estates estimate 25-26 onwards						2,000	**2,000**
Pwllheli PS	**879**						**980**
Holyhead PS	**0**	750	2,593				**3,343**
FHQ Complex + Canteen	**175**						**175**
Caernarfon & North Gwynedd Estate Area	**0**	800					**800**
VCC / Vehicle Workshop	**800**	2,070					**2,870**
Dolgellau PS					1,000		**1,000**
Abergele PS			391				**391**
Llanrwst PS					178		**178**
Flintshire Hub		500	4,000	1,500			**6,000**
Force Control Room Upgrading			100				**100**
Archive Store				750			**750**
Rhosllanerchrugog PS					190		**190**
Re locate/ co locate/ vacate	**0**	350					**350**
Custody CCTV	**0**						**0**
Firearms Base works	**10**	282					**391**
CS - SARC ISO Accreditation		150					**150**
Total Building Works	**1,889**	**5,104**	**7,184**	**2,350**	**1,468**	**2,100**	**20,295**
Vehicles and Other Equipment							
Vehicle Purchase Replacement Programme	**1,850**	1,847	1,981	1,426	1,426	1,426	**9,956**
Tranman development	**0**	75					**75**
Dexun System (Strategic Control Centre)	**22**						**78**
Intoxilators x 3	**30**						**30**
ANPR replacement	**0**	470					**470**
Collision Surveying Equipment	**131**						**131**
Total Vehicles and Other Equipment	**2,033**	**2,392**	**1,981**	**1,426**	**1,426**	**1,426**	**10,740**

Description	2020-21 Revised Estimate	2021-22 Est	2022-23 Est	2023-24 Est	2024-25 Est	2025-26 Est	Total Project Costs
	£000	£000	£000	£000	£000	£000	£000
Information Technology and Communication Equipment							
Desk Top Replacement (Replacement Programme)	**1,100**	437	750	750	750	300	**6,960**
Lockers for charging and storage	**50**	150					**200**
Mobile app		471					471
Server Replacement		700				700	**2,072**
Business Systems Servers (Replacement Programme)		145				150	**457**
Mobile data devices	**0**	566			0	460	**1,976**
Airwave (replacement units)	**79**						**533**
DFU Server replacement				270			**562**
Mobile Responder App	**0**	0					**114**
NEP Infrastructure/Sail Point/Internet Links	**430**	146					**1,265**
Connectivity Software	**0**						**0**
Wifi	**52**	354					**500**
Digital Workplace audio visual	**0**	126					**200**
Single on line Home (Digital Public Contact)		0					**0**
Digital Intelligence & Investigation		196					**196**
DFU Automate	**15**						**15**
Digital Evidence Management	**125**						**125**
CISCO Telephony	**0**	250					**250**
Nexus Memory Upgrade	**13**	37					**50**
Backup	**30**						**157**
LAN	**20**	60					**80**
Unsupported systems (Risk Register)	**86**	38					**124**
ICAD Upgrade Phase 1	**105**	25					**172**
Command and Control Upgrade - Phase 2		2,458					2,458
Body Worn Video	**60**						592
GIS Update	**0**						70
LPS - Community Safety - Prevention		30					30
CS - COTS Standard Surveillance (RIPA) System		80					80
CS - CHIS system		88					88
POD - 360 Virtual Training		**53**					53
Digital - BIU - Mgmt Info Data Warehouse		**50**					50
CHORUS new module		**35**					35
ICT Sourcing Strategy		**250**	**750**				1,000
Life-X Deployment			**300**		**800**		1,100
Emergency Service Netwrok		**686**	**6,560**		**900**		8,146
NEP Device Re-build		**175**					175
Body Worn Video (replacement costs)			**244**	**243**	**244**	**244**	974
Total Information Technology and Communication	**2,165**	**7,606**	**8,604**	**1,263**	**2,694**	**1,854**	**31,330**
Total Capital Expenditure	**6,087**	**15,102**	**17,769**	**5,039**	**5,588**	**5,380**	**62,365**

Description	2020-21 Revised Estimate £000	2021-22 Est £000	2022-23 Est £000	2023-24 Est £000	2024-25 Est £000	2025-26 Est £000
Total Building Works	1,889	5,104	7,184	2,350	1,468	2,100
Total Vehicles and Other Equipment	2,033	2,392	1,981	1,426	1,426	1,426
Total Information Technology and Communication	2,165	7,606	8,604	1,263	2,694	1,854
Total Capital Expenditure	**6,087**	**15,102**	**17,769**	**5,039**	**5,588**	**5,380**
Funding						
Home Office Grant	123	123	123	123	123	123
Revenue Contribution	2,691	2,070	2,054	2,053	2,053	1,968
Earmarked Reserves	539	5,289	2,100	0	0	0
Capital Receipts	55	242	100	370	750	100
Borrowing for Estates	1,854	4,580	7,084	2,250	718	2,000
Borrowing for replacement programme	825	2,798	6,308	243	1,944	1,189
Total Funding	**6,087**	**15,102**	**17,769**	**5,039**	**5,588**	**5,380**
External sources	123	123	123	123	123	123
Own resources	3,285	7,601	4,254	2,423	2,803	2,068
Debt	2,679	7,378	13,392	2,493	2,662	3,189
TOTAL	**6,087**	**15,102**	**17,769**	**5,039**	**5,588**	**5,380**

Appendix B

Annual Minimum Revenue Provision Statement 2021/22

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 2021/22 will not be subject to a MRP charge until 2022/23.

Based on the Police and Crime Commissioner's latest estimate of its capital financing requirement (CFR) on 31st March 2021, the budget for MRP has been set as follows:

	31.03.2021 Estimated CFR £m	2021/22 Estimated MRP £
Capital expenditure before 01.04.2008	7.5	0.3
Capital expenditure after 31.03.2008	13.9	1.6
Leases and Private Finance Initiative	9.1	0.9
Total General Fund CFR	**30.5**	**2.8**

Appendix C

Treasury Management Strategy Statement 2021/22

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 Police and Crime Commissioner Investments in November 2019 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 impact on the UK from coronavirus, lockdown measures, the rollout of vaccines, as well as the new trading arrangements with the European Union (EU), will remain major influences on the Police and Crime Commissioner’s treasury management strategy for 2021/22.

2.2. The Bank of England (BoE) maintained Bank Rate at 0.10% in December 2020 and Quantitative Easing programme at £895 billion having extended it by £150 billion in the previous month. The Monetary Policy Committee (MPC) voted unanimously for both, but no mention was made of the potential future use of negative interest rates. In the November Monetary Policy Report (MPR) forecasts, the Bank expects the UK economy to shrink -2% in Q4 2020 before growing by 7.25% in 2021, lower than the previous forecast of 9%. The BoE also forecasts the economy will now take until Q1 2022 to reach its pre-pandemic level rather than the end of 2021 as previously forecast. By the time of the December MPC announcement, a COVID-19 vaccine was approved for use, which the Bank noted would reduce some of the downside risks to the economic outlook outlined in the November MPR.

2.3. UK Consumer Price Inflation (CPI) for November 2020 registered 0.3% year on year, down from 0.7% in the previous month. Core inflation, which excludes the more volatile components, fell to 1.1% from 1.5%. The most recent labour market data for the three months to October 2020 showed the unemployment rate rose to 4.9% while the employment rate fell to 75.2%. Both measures are expected to deteriorate further due to the ongoing impact of coronavirus on the jobs market, particularly when the various government job retention schemes start to be unwound in 2021, with the BoE forecasting unemployment will peak at 7.75% in Q2 2021. In October, the headline 3-month average annual growth rate for wages were 2.7% for total pay and 2.8% for regular pay. In real terms, after adjusting for inflation, total pay growth was up by 1.9% while regular pay was up 2.1%.

2.4. GDP growth rebounded by 16.0% in Q3 2020 having fallen by -18.8% in the second quarter, with the annual rate rising to -8.6% from -20.8%. All sectors rose quarter-on-quarter, with dramatic gains in construction (41.2%), followed by services and production (both 14.7%). Monthly GDP estimates have shown the economic recovery slowing and remains well below its pre-pandemic peak. Looking ahead, the BoE's November MPR forecasts economic growth will rise in 2021 with GDP reaching 11% in Q4 2021, 3.1% in Q4 2022 and 1.6% in Q4 2023.

2.5. GDP growth in the euro zone rebounded by 12.7% in Q3 2020 after contracting by -3.7% and -11.8% in the first and second quarters, respectively. Headline inflation, however, remains extremely weak, registering -0.3% year-on-year in November, the fourth successive month of deflation. Core inflation registered 0.2% y/y, well below the European Central Bank's (ECB) target of 'below, but close to 2%'. The ECB is expected to continue holding its main interest rate of 0% and deposit facility rate of -0.5% for some time but expanded its monetary stimulus in December 2020, increasing the size of its asset purchase scheme to €1.85 trillion and extended it until March 2022.

2.6. The US economy contracted at an annualised rate of 31.4% in Q2 2020 and then rebounded by 33.4% in Q3. The Federal Reserve maintained the Fed Funds rate at between 0% and 0.25% and announced a change to its inflation targeting regime to a more flexible form of average targeting. The Fed also provided strong indications that interest rates are unlikely to change from current levels over the next three years.

2.7. Former vice-president Joe Biden won the 2020 US presidential election. Mr Biden is making tackling coronavirus his immediate priority and will also be reversing several executive orders signed by his predecessor and take the US back into the Paris climate accord and the World Health Organization.

2.8. **Credit outlook:** After spiking in late March as coronavirus became a global pandemic and then rising again in October/November, credit default swap (CDS) prices for the larger UK banks have steadily fallen back to almost pre-pandemic levels. Although uncertainly around COVID-19 related loan defaults lead to banks provisioning billions for potential losses in the first half of 2020, drastically reducing profits, reported impairments for Q3 were much reduced in some institutions. However, general bank profitability in 2020 and 2021 may be significantly lower than in previous years. The credit ratings for many UK institutions were downgraded on the back of downgrades to the sovereign rating. Credit conditions more generally though in banks and building societies have tended to be relatively benign, despite the impact of the pandemic.

2.9. Looking forward, the potential for bank losses to be greater than expected when government and central bank support starts to be removed remains a risk, suggesting a cautious approach to bank deposits in 2021/22 remains advisable.

2.10. **Interest rate forecast:** The Police and Crime Commissioner's treasury management adviser Arlingclose is forecasting that BoE Bank Rate will remain at 0.1% until at least the first quarter of 2024. The risks to this forecast are judged to be to the downside as the BoE and UK government continue to react to the coronavirus pandemic and the new EU trading arrangements. The BoE extended its asset purchase programme to £895 billion in November while keeping Bank Rate on hold and maintained this position in December. However, further interest rate cuts to zero, or possibly negative, cannot yet be ruled out but this is not part of the Arlingclose central forecast.

2.11. Gilt yields are expected to remain very low in the medium-term while short-term yields are likely remain below or at zero until such time as the BoE expressly rules out the chance of negative interest rates or growth/inflation prospects improve. The central case is for 10-year and 20-year to rise to around 0.60% and 0.90% respectively over the time horizon. The risks around the gilt yield forecasts are judged to be broadly balanced between upside and downside risks, but there will almost certainly be short-term volatility due to economic and political uncertainty and events.

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

3. **Local Context**

3.1. On 31st March 2021, the Police and Crime Commissioner is expected to hold £9.4m of borrowing and £20.6m of treasury investments. Forecast changes in these sums are shown in the balance sheet analysis in table 1 below.

Table 1: Balance sheet summary and forecast

	31.3.20 Actual £m	31.3.21 Estimate £m	31.3.22 Forecast £m	31.3.23 Forecast £m	31.3.24 Forecast £m	31.3.25 Forecast £m	31.3.26 Forecast £m
General Fund CFR	30.4	**30.5**	**35.1**	**45.4**	**43.5**	**41.9**	**40.5**
Less: Other debt liabilities *	-9.9	-9.1	-8.2	-7.3	-6.2	-5.1	-3.9
Loans CFR	**20.5**	**21.4**	**26.9**	**38.1**	**37.3**	**36.8**	**36.6**
Less: External borrowing (long term)**	-9.9	-9.4	-8.9	-8.4	-7.9	-7.4	-6.9
Less: External borrowing (short term)**	-5.0	0.0	0.0	0.0	0.0	0.0	0.0
Internal borrowing	**5.6**	**12.1**	**18.0**	**29.7**	**29.4**	**29.4**	**29.7**
Less: Usable reserves	-25.2	-28.7	-25.2	-21.8	-18.9	-18.0	-17.3
Plus: Working capital	4.1	-4.0	0.2	0.2	0.2	0.2	0.2
New borrowing / (Investments)	**-15.5**	**-20.6**	**-7.0**	**8.1**	**10.7**	**11.6**	**12.6**

* 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 £22m 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 2021/22.

3.5. **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 the same forecasts as table 1 above, but that cash and investment balances are kept to a minimum level of **£10m** at each year-end to maintain sufficient liquidity but minimise credit risk.

Table 2: Liability benchmark

	31.3.20 Actual £m	**31.3.21 Estimate £m**	**31.3.22 Forecast £m**	**31.3.23 Forecast £m**	**31.3.24 Forecast £m**	**31.3.25 Forecast £m**	**31.3.26 Forecast £m**
Loans CFR	20.5	21.4	26.9	38.1	37.3	36.8	36.6
Less: Usable reserves	-25.2	-28.7	-25.2	-21.8	-18.9	-18.0	-17.3
Plus: Working capital	4.1	-4.0	0.2	0.2	0.2	0.2	0.2
Net Borrowing Requirement / (Investments)	**-0.6**	**-11.3**	**1.9**	**16.5**	**18.6**	**19.0**	**19.5**
Minimum investments	10.0	10.0	10.0	10.0	10.0	10.0	10.0
Liability Benchmark	**9.4**	**-1.3**	**11.9**	**26.5**	**28.6**	**29.0**	**29.5**

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 and cash-flow forecast in order to minimise risk. The cash-flow forecast reflects the peaks and troughs over the financial year whereas the liability benchmark reflects a specific point in time.

4. **Borrowing Strategy**

4.1. The Police and Crime Commissioner currently holds £9.4 million of loans, a decrease of £5.5 million on the previous year, as part of its strategy for funding previous years' capital programmes. The balance sheet forecast in table 1 shows that the Police and Crime Commissioner does not expect to need to borrow in 2021/22. The Police and Crime Commissioner may however borrow to pre-fund future years' requirements, providing this does not exceed the authorised limit for borrowing of £27.9 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 2021/22 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. A HM Treasury consultation on lowering PWLB rates concluded in July 2020 but the government has yet to publish its response. In the meantime, the Police and Crime Commissioner will consider long-term loans from other sources including banks, pensions and local authorities, in order to lower interest costs and reduce over-reliance on one source of funding in line with the CIPFA Code.

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 unplanned cash flow shortages.

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

- HM Treasury's PWLB lending facility (formerly the Public Works Loan Board)
- any institution approved for investments (see below)
- any other bank or building society authorised to operate in the UK
- any other UK public sector body
- UK public and private sector pension funds (except 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:

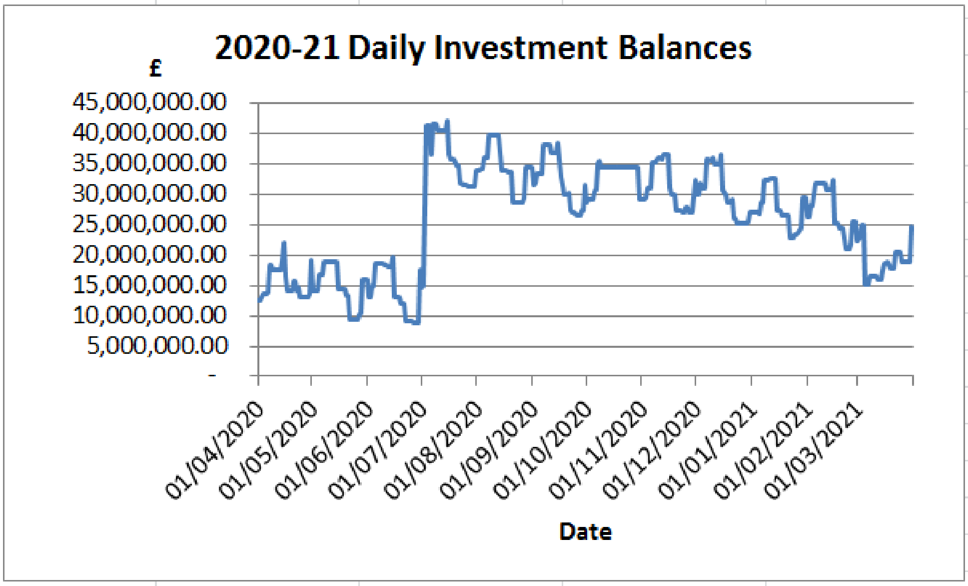
- leasing
- hire purchase
- Private Finance Initiative
- sale and leaseback

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. **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. **Treasury 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 treasury investment balance has ranged between £8.8 million (on the 29th of June 2020) and £42.2 million (on the 15th July 2020), and similar patterns are expected to be maintained in the forthcoming year.

Graph 1: Daily investment balance (2020-21)



5.2. **Objectives:** Both the CIPFA Code and the WG Guidance require the Police and Crime Commissioner to invest its treasury 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:** The COVID-19 pandemic has increased the risk that the Bank of England will 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. Since investments cannot pay negative income, negative rates will be applied by reducing the value of investments. 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 2021/22. 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 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 limits shown.

Table 3: Treasury investment counterparties and limits

Sector	Counterparty limit	Sector limit
The UK Government	Unlimited	n/a
Local authorities & other government entities	£7m	Unlimited
HSBC[1*]	£10m	n/a
Secured investments *	£7m	Unlimited
Banks (unsecured) *	£4m	Unlimited
Building societies (unsecured) *	£4m	Unlimited
Registered providers (unsecured) *	£4m	£4m
Money market funds *	£4m	Unlimited
Strategic pooled funds*	£4m	£4m

1 These are the Commissioner's bankers and are currently rated AA- by Fitch credit rating agency.
This table must be read in conjunction with the notes below

5.7. **Minimum credit rating:** Treasury investments in the sectors marked with an asterisk will only be made with entities whose lowest published long-term credit rating is no lower than A-. Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used. However, investment decisions are never made solely based on credit ratings, and all other relevant factors including external advice will be taken into account.

5.8. **Government:** Loans to, and bonds and bills issued or guaranteed by, national governments, regional and local authorities and multilateral development banks. These investments are not subject to bail-in, and there is generally a lower risk of insolvency, although they are not zero risk. Investments with the UK Government are deemed to be zero credit risk due to its ability to create additional currency.

5.9. **Secured investments:** Investments secured on the borrower's assets, which limits the potential losses in the event of insolvency. The amount and quality of the security will be a key factor in the investment decision. Covered bonds and reverse repurchase agreements with banks and building societies are exempt from bail-in. Where there is no investment specific credit rating, but the collateral upon which the investment is secured has a credit rating, the higher of the collateral credit rating and the counterparty credit rating will be used. The combined secured and unsecured investments with any one counterparty will not exceed the cash limit for secured investments.

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

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

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

5.13. **Strategic pooled funds:** Bond, equity and property funds that offer enhanced returns over the longer term but are more volatile in the short term. These allow the Police and Crime Commissioner to diversify into asset classes other than cash without the need to own and manage the underlying investments. Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Police and Crime Commissioner's investment objectives will be monitored regularly.

5.14. **Operational bank accounts:** The Police and Crime Commissioner may incur operational exposures, for example through 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.

5.15. **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.

5.16. Where a credit rating agency announces that a credit rating is on review for possible downgrade (also known as “negative watch”) 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.

5.17. **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.

5.18. When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008 and 2020, this is not generally reflected in credit ratings, but can be seen in other market measures. In these circumstances, the 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, or with other local authorities. This will cause investment returns to fall but will protect the principal sum invested.

5.19. **Investment limits**: The Police and Crime Commissioner’s revenue reserves available to cover investment losses are forecast to be £28.7 million on 31st March 2021. A group of entities under the same ownership will be treated as a single organisation for limit purposes. Credit risk exposures arising from non-treasury investments, financial derivatives and balances greater than £10,000 in operational bank accounts count against the relevant investment limits.

5.20. **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. The Police and Crime Commissioner will spread its liquid cash over approved providers (e.g. bank accounts and money market funds) to ensure that access to cash is maintained in the event of operational difficulties at any one provider.

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 investments	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. For practical purposes a lower operational limit of £7.5 million for a maximum of 14 days will be set to avoid unnecessary short term borrowing.

Liquidity risk indicator	Limit
Minimum cash available within 12 months	£10m
Lower limit for a maximum of 14 days	£7.5m

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	2021/22	2022/23	2023/24
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.2.**

8. **Financial Implications**

8.1. The budget for investment income in 2021/22 is £0.1 million, based on an average investment portfolio of £10 million at an interest rate of 0.01%. The budget for debt interest paid in 2021/22 is £0.166 million, based on committed fixed rate long term loans and an estimate to cover potential short term borrowing. 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 – December 2020

Underlying assumptions:

- The medium-term global economic outlook has improved with the distribution of vaccines, but the recent upsurge in coronavirus cases has worsened economic prospects over the short term.
- Restrictive measures and further lockdowns are likely to continue in the UK and Europe until the majority of the population is vaccinated by the second half of 2021. The recovery period will be strong thereafter, but potentially longer than previously envisaged.
- Signs of a slowing UK economic recovery were already evident in UK monthly GDP and PMI data, even before the second lockdown and Tier 4 restrictions. Employment is falling despite an extension to support packages.
- The need to support economic recoveries and use up spare capacity will result in central banks maintaining low interest rates for the medium term.
- Brexit will weigh on UK activity. The combined effect of Brexit and the after-effects of the pandemic will dampen growth relative to peers, maintain spare capacity and limit domestically generated inflation. The Bank of England will therefore maintain loose monetary conditions for the foreseeable future.
- Longer-term yields will also remain depressed, anchored by low central bank policy rates, expectations for potentially even lower rates and insipid longer-term inflation expectations. There is a chance yields may follow a slightly different path in the medium term, depending on investor perceptions of growth and inflation, or the deployment of vaccines.

Forecast:

- Arlingclose expects Bank Rate to remain at the current 0.10% level.
- Our central case for Bank Rate is no change, but further cuts to zero, or perhaps even into negative territory, cannot be completely ruled out.
- Gilt yields will remain low in the medium term. Shorter term gilt yields are currently negative and will remain around zero or below until either the Bank expressly rules out negative Bank Rate or growth/inflation prospects improve.
- Downside risks remain, and indeed appear heightened, in the near term, as the government reacts to the escalation in infection rates and the Brexit transition period ends.

	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24
Official Bank Rate													
Upside risk	0.00	0.00	0.15	0.15	0.15	0.15	0.30	0.30	0.30	0.30	0.30	0.30	0.30
Arlingclose Central Case	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
Downside risk	0.30	0.40	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
3-month money market r.													
Upside risk	0.05	0.05	0.10	0.10	0.15	0.20	0.30	0.30	0.30	0.30	0.30	0.30	0.30
Arlingclose Central Case	0.10	0.10	0.15	0.15	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20
Downside risk	0.30	0.40	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
1yr money market rate													
Upside risk	0.05	0.05	0.10	0.10	0.15	0.20	0.40	0.40	0.40	0.40	0.40	0.40	0.40
Arlingclose Central Case	0.15	0.15	0.25	0.25	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30
Downside risk	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.15
5yr gilt yield													
Upside risk	0.40	0.40	0.45	0.45	0.50	0.50	0.55	0.60	0.60	0.65	0.65	0.70	0.70
Arlingclose Central Case	0.00	0.00	0.05	0.10	0.15	0.20	0.20	0.20	0.25	0.25	0.25	0.25	0.25
Downside risk	0.40	0.45	0.50	0.55	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.60
10yr gilt yield													
Upside risk	0.30	0.35	0.40	0.45	0.50	0.50	0.55	0.60	0.60	0.65	0.65	0.70	0.70
Arlingclose Central Case	0.25	0.30	0.35	0.35	0.40	0.40	0.45	0.45	0.50	0.55	0.55	0.55	0.60
Downside risk	0.50	0.50	0.55	0.55	0.55	0.55	0.55	0.55	0.55	0.55	0.55	0.55	0.55
20yr gilt yield													
Upside risk	0.40	0.40	0.45	0.45	0.50	0.50	0.55	0.60	0.60	0.65	0.65	0.70	0.70
Arlingclose Central Case	0.70	0.70	0.75	0.75	0.75	0.80	0.80	0.85	0.85	0.85	0.85	0.90	0.90
Downside risk	0.30	0.30	0.35	0.35	0.35	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40
50yr gilt yield													
Upside risk	0.40	0.40	0.45	0.45	0.50	0.50	0.55	0.60	0.60	0.65	0.65	0.70	0.70
Arlingclose Central Case	0.60	0.60	0.65	0.65	0.65	0.70	0.70	0.75	0.75	0.75	0.75	0.80	0.80
Downside risk	0.30	0.30	0.35	0.35	0.35	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40

PWLB Certainty Rate (Maturity Loans) = Gilt yield + 0.80%

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

Additional requirements of Welsh Government Investment Guidance

The Welsh Government (WG) published revised Investment Guidance in November 2019 which places additional reporting requirements upon local authorities that are not integral to this Police and Crime Commissioner's treasury management processes. The guidance also covers investments that are not part of treasury management, for example investment property and loans to local organisations.

Contribution: The Police and Crime Commissioner's investments contribute to its service delivery objectives and supports effective treasury management activities.

Climate change: The Police and Crime Commissioner's investment decisions consider long-term climate risks to support a low carbon economy.

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

- denominated in pound sterling,
- due to be repaid within 12 months of arrangement unless the counterparty is a local Authority,
- not defined as capital expenditure by legislation, and
- invested with one of:
  - the UK Government,
  - a UK local Authority, 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.

Loans: The WG Guidance defines a loan as a written or oral agreement where the Police and Crime Commissioner temporarily transfers cash to a third party, joint venture, subsidiary or associate who agrees a return according to the terms and conditions of receiving the loan, except where the third party is another local Police and Crime Commissioner. The Police and Crime Commissioner does not provide loans of this nature.

The Police and Crime Commissioner uses an allowed 'expected credit loss' model for loans and receivables as set out in *International Financial Reporting Standard 9 Financial Instruments* as adopted by proper practices to measure the credit risk of its loan portfolio. Appropriate consideration is given to state aid rules and competition law. The Police and Crime Commissioner has appropriate credit control arrangements to recover overdue repayments in place.

Non-specified investments: Any financial investment not meeting the definition of a specified investment or a loan is classed as non-specified. Given the wide definition of a loan, this category only applies to units in pooled funds and shares in companies. The Police and Crime Commissioner confirms that it currently doesn't have any non-specified investments.

Non-financial investments: This category covers non-financial assets held primarily or partially to generate a profit, primarily investment property. Security is determined by comparing each asset's purchase price to its fair value using the model in International Accounting Standard 40: Investment Property as adapted by proper practices. The Police and Crime Commissioner confirms that it currently doesn't hold any non-financial investments.

Investment advisers: The Police and Crime Commissioner has appointed Arlingclose Limited as treasury management advisers. 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 £36.1 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.

Capacity and skills: 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.

Corporate 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.