Section A For Publication

THE OFFICE OF POLICE AND CRIME COMMISSIONER FOR DERBYSHIRE

DECISION RECORD

Request for PCC Decision	Received in OPCC Date: 16 February 2017	OPCC Ref: 10/17

Title: Capital Prudential Indicators (incl. Minimum Revenue Provision Policy), Treasury Management Strategy and Investment Strategy for 2017/20

Executive Summary:

The Capital Prudential Indicators (incl. Minimum Revenue Provision Policy), Treasury Management Strategy and Investment Strategy for 2017/20 were considered by the Police and Crime Commissioner (PCC) at the Strategic Governance Board held on 23 January 2017.

The proposals were scrutinised at the Board and reviewed beforehand by the PCC's own Chief Finance Officer. Having decided at the Strategic Governance Board to approve the proposals, the PCC has since sought and received support of the Police & Crime Panel on 26 January 2017 for his revenue budget and resultant precept level. As some elements of the revenue budget inherently link to and impact on the proposals, the PCC is now in a position to formally approve it.

The proposals in respect of the Capital Prudential Indicators (incl. Minimum Revenue Provision Policy), Treasury Management Strategy and Investment Strategy for 2017/20, item 10A (and the supporting appendices), can be viewed in full under the Strategic Governance Board section of the PCC's website: http://www.derbyshire-pcc.gov.uk/Document-Library/Meetings/SGB-Meetings/2017/23-January-2017/Combined-SGB-2017.01.23-i.pdf

Decision
i. That the Prudential Indicators and Limits for 2017/18 to 2019/20 contained within Appendix A of item 10A are approved. ii. That the Minimum Revenue Provision (MRP) Statement contained within Appendix A of item 10A be approved. iii. That the Treasury Management Strategy for 2017/18 to 2019/20 and the Treasury Prudential Indicators contained within Appendix B of item 10A be approved. iv. That the Authorised Limit Prudential Indicator be approved. v. That the Investment Strategy 2017/20 contained in the Treasury Management Strategy (Appendix B), the counterparties in Appendix B2 and detailed criteria included in Appendix B3 be approved. vi. That the adoption of the CIPFA Treasury Management Code of Practice be reaffirmed.

Declaration	
I confirm that I have considered whether or not I have any personal or prejudicial interest in this matter and take the proposed decision in compliance with the Code of Conduct for the Police and Crime Commissioner for Derbyshire. Any such interests are recorded below. None The above request has my approval.	
Signature Hardyal Dhindsa	**Date** 16 February 2017
PUBLICATION SCHEME CONSIDERATIONS	
Is the related Section B report to be published Yes The report contains commercially sensitive information.	

Is the publication of this approval to be deferred **No**

If Yes, provide reasons below

Date to be deferred to –

NB Statutory Instrument 2011/3050 (as amended by SI 2012/2479) states that: *all decisions made by a PCC are in the types of information that must "be published as soon as practicable after it becomes available to the elected local policing body".*

OFFICER APPROVAL

Chief Executive or Nominee:

I have been consulted about the proposal and confirm that financial, legal and equalities advice has been taken into account in the preparation of this report.

I am satisfied that this is an appropriate request to be submitted to the Police and Crime Commissioner

Name Andrew Dale (Chief Finance Officer) **Date** 16 February 2017

STRATEGIC GOVERNANCE BOARD

23 JANUARY 2017

JOINT REPORT OF CHIEF CONSTABLE AND THE TREASURER TO THE POLICE AND CRIME COMMISSIONER

10C: PRUDENTIAL INDICATORS, MINIMUM REVENUE PROVISION, TREASURY MANAGEMENT AND INVESTMENT STRATEGY

1. PURPOSE OF THE REPORT

1.1 To consider and approve the Capital Prudential Indicators for 2017/18 to 2019/20 (incorporating the Minimum Revenue Provision Policy), the Treasury Management Strategy Statement 2017/20 and the Investment Strategy 2017/20.

2. INFORMATION AND ANALYSIS

2.1 As part of the budget setting process, it is a statutory requirement that the Police and Crime Commissioner (PCC) determines the Prudential Indicators and Treasury Management Policies and Procedures.

2.2 The Commissioner fulfils four key legislative requirements when setting prudential indicators and setting out the expected treasury operations.

2.3 The reporting of the prudential indicators considers the affordability and impact of capital expenditure decisions. They set out the organisation's capital framework and capital activities (as required by the CIPFA Prudential Code for Capital Finance in Local Authorities) shown at Appendix A. The treasury management prudential indicators are included as treasury indicators in the CIPFA Treasury Management Code of Practice.

2.4 The Minimum Revenue Provision (MRP) Policy, which sets out how the organisation will pay for capital assets through revenue each year (as required by Regulation under the Local Authorities [Capital Finance and Accounting][England] Amendment Regulations 2008) shown at Appendix A.

2.5 The Treasury Management Strategy Statement sets out how the organisation intends to finance its capital programme. It shows how the treasury service will support the capital decisions taken above, the day to day treasury management and the limitations on activity through treasury prudential indicators. The key indicator is the Authorised Limit, the maximum amount of debt the organisation could afford in the short term, but which would not be sustainable in the longer term. This is the Affordable Borrowing Limit required by s3 of the Local Government Act 2003. This is in accordance with the CIPFA Code of Practice on Treasury Management and the CIPFA Prudential Code shown at Appendix B.

2.6 The Investment Strategy which sets out how the organisation will manage its investments and limit its exposure to risk. It sets out the criteria for choosing investment counterparties and limiting exposure to the risk of loss. This strategy is in accordance with the Department for Communities and Local Government (CLG) Investment Guidance, and shown at Appendix B.

3. RECOMMENDATIONS

3.1 That the Prudential Indicators and Limits for 2017/18 to 2019/20 contained within Appendix A of the report are approved.

3.2 That the Minimum Revenue Provision (MRP) Statement contained within Appendix A which sets out the PCC's policy on MRP be approved.

3.3 That the Treasury Management Strategy 2017/18 to 2019/20, and the treasury Prudential Indicators contained within Appendix B be approved.

3.4 That the Authorised Limit Prudential Indicator be approved.

3.5 That the Investment Strategy 2017/20 contained in the treasury management strategy (Appendix B), the counterparties in Appendix B2 and detailed criteria included in Appendix B3 be approved.

3.6 That the adoption of the CIPFA Treasury Management Code of Practice be reaffirmed.

4. IMPLICATIONS

	LOW	MEDIUM	HIGH
Crime & Disorder	X		
Environmental	X		
Equality & Diversity	X		
Financial			X
Health & Safety	X		
Human Rights	X		
Legal	X		
Personnel	X		
Risk	X		

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APPENDIX DETAILS

A The Capital Prudential Indicators 2017/18-2019/20

B Treasury Management Strategy 2017/18-2019/20

B1 Treasury Management Practice (TMP) 1 – Credit and Counterparty Risk Management

B2 Approved Counterparties (based on credit ratings as at January 2017)

B3 Detailed Criteria and Credit Ratings

The Capital Prudential Indicators 2017/18 – 2019/20

Introduction

1. The Local Government Act 2003 requires the Commissioner to adopt the CIPFA Prudential Code and produce prudential indicators. Each indicator either summarises the expected capital activity or sets limits upon that activity, and reflects the outcome of the Commissioner's underlying capital appraisal systems. This report updates currently approved indicators and introduces new indicators for 2019/20. Where appropriate the 2015/16 Actual figures are provided for information.

2. Within this overall prudential framework there is an impact on the Commissioner's treasury management activity – as it will directly impact on borrowing or investment activity. As a consequence the treasury management strategy for 2017/18 to 2019/20 is included as Appendix B to complement these indicators. Some of the prudential indicators are shown in the treasury management strategy to aid understanding.

The Commissioner's Capital Expenditure Plans

3. The Commissioner's capital expenditure plans are the key driver of treasury management activity and form the first of the prudential indicators. A certain level of capital expenditure is grant-supported by the Government; any decisions by the Commissioner to spend above this level will be considered to be 'unsupported' capital expenditure. This unsupported capital expenditure needs to have regard to:
   - Service objectives (e.g. strategic planning);
   - Stewardship of assets (e.g. asset management planning);
   - Value for money (e.g. option appraisal);
   - Prudence and sustainability (e.g. implications for external borrowing and whole life costing);
   - Affordability (e.g. implications for the police precept);
   - Practicality (e.g. the achievability of the forward plan).

4. The revenue consequences of capital expenditure, particularly the unsupported capital expenditure, will need to be paid for from the organisation's own resources.

5. This capital expenditure can be paid for immediately by applying capital resources such as capital receipts, capital grants etc or by applying revenue resources. However if the resources available are insufficient any residual capital expenditure will add to the Commissioner's borrowing need.

6. As described in the report on the proposed Capital Programme for 2017/21 presented to this meeting, capital grant allocations have been cut back drastically during the recent period of austerity and this trend has continued for 2017/18. At £0.6m the force's capital grant allocation for next year is very small in the context of the expenditure

planned. Likewise although some capital receipts are anticipated over the period, these are fairly limited as well.

7. The availability of capital reserves to help offset the borrowing need will depend to a significant extent on the amount of reserves that are required to support the revenue budget during 2017/18 and beyond.

8. The 2017/18 settlement announced in December was less positive in this respect than forecasts made following the 2015 Comprehensive Spending Review. In particular, the settlement made it clear that the Government intends to claw back substantially all the additional funding that forces can raise via increases in the Precept by adjusting reductions in Home Office revenue grant to mirror these increases.

9. The ‘across-the-board’ reduction in revenue grant of 1.4% was the maximum possible without breaching the commitment that each force would have at least the same cash funding in 2017/18 than in 2015/16. Consequently, under the Home Office’s assumptions, changes in forces’ total cash funding will vary from 0% to +2.2%, with Derbyshire’s forecast to increase by +0.8%. In view of this it must be assumed that the same procedure will apply in future years, with changes in Derbyshire’s grant driven by taxbase changes experienced across the country.

10. Although the Home Office has signalled its commitment to press ahead with introducing a revised funding formula, it would not be prudent at this stage to rely on this for an improvement in Derbyshire’s funding positon.

11. Therefore, given the above, it is assessed that of the forecast balance of £12.268m on the Operational Funding and Investment Reserve at 31 March 2017 only £5.238m can be released to support the proposed capital programme.

12. The Commissioner is asked to approve the summary capital expenditure projections in the table below, which also sets out how they are to be financed. This forms the first prudential indicator.

Capital Expenditure	**2015/16 Actual £m**	**2016/17 Revised £m**	**2017/18 Estimate £m**	**2018/19 Estimate £m**	**2019/20 Estimate £m**
Capital Expenditure	10.082	21.354	12.246	11.911	4.674
Financed by:					
Capital receipts	0.216	1.559	0.842	0.880	0.480
Capital grants/contributions	1.952	7.620	4.501	0.837	0.695
Capital reserves	6.503	10.275	5.238	0	0
Revenue Contributions	1.411	1.900	1.665	1.594	1.594
Net financing need for the year	**0**	**0**	**0**	**8.600**	**1.905**

The Commissioner's Borrowing Need (the Capital Financing Requirement)

13. The second prudential indicator is the Capital Financing Requirement (CFR). The CFR is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Commissioner's underlying borrowing need. Any capital expenditure above, which has not immediately been paid for, will increase the CFR. Based on the current Capital Programme, external borrowing will be required in 2018/19 and 2019/20.

14. The CFR does not increase indefinitely, as the minimum revenue provision (MRP) is a statutory annual revenue charge which broadly reduces the borrowing need in line with the MRP policy.

15. The CFR includes other long term liabilities (ie from PFI schemes) brought onto the balance sheet. Whilst this increases the CFR, and therefore the borrowing requirement, these types of scheme include a borrowing facility and so there is no requirement to separately borrow for these schemes. There are currently £12.0m of such schemes within the CFR.

16. The Commissioner is asked to approve the CFR projections below:

	2015/16 Actual £m	2016/17 Revised £m	2017/18 Estimate £m	2018/19 Estimate £m	2019/20 Estimate £m
Capital Financing Requirement					
Total CFR	**27.684**	**26.260**	**24.883**	**31.949**	**32.306**
Movement in CFR	**(1.203)**	**(1.424)**	**(1.377)**	**7.066**	**0.357**
Movement in CFR represented by					
Net financing need for the year (above)	0.000	0.000	0.000	8.600	1.905
Less MRP/VRP and other financing movements	1.203	1.424	1.377	1.534	1.548
Movement in CFR	**(1.203)**	**(1.424)**	**(1.377)**	**7.066**	**0.357**

.Note: The MRP/VRP will include PFI lease annual principal payments

Minimum Revenue Provision (MRP) policy statement

17. The Commissioner is required to pay off an element of the accumulated capital spend each year through a revenue charge (the Minimum Revenue Provision - MRP). He is also allowed to make additional voluntary payments (VRP).

18. CLG Regulations require the Commissioner to approve **an MRP Statement** in advance of each year. A variety of options are provided to Authorities, so long as there is a prudent provision. The Commissioner is recommended to approve the following MRP Statement.

19. For capital expenditure incurred before 1 April 2008 or which in the future is Supported Capital Expenditure, the MRP policy will be:

- **Based on CFR** – MRP will be based on the CFR, being 4% of the opening balance on the CFR for that year (Option 2).

20. From 1 April 2008 for all unsupported borrowing the MRP policy will be:

- **Based on the Asset Life Method** – MRP will be based on the estimated life of the assets equal instalment method, in accordance with the regulations (Option 3).

The only current unsupported borrowing is that used to fund the Centralised Contact Management Centre, which has an asset life of 50 years. The Constabulary's plans indicate that further unsupported borrowing will be needed in 2018/19 and 2019/20. It is assessed that this borrowing will be against assets with an estimated life of 25 years.

21. For Finance leases and PFI contracts that are deemed to be 'on balance sheet', the MRP requirement would be regarded as met by a charge equal to the element of the rent/charge that goes to write down the balance sheet liability.

The Use of the Commissioner's Resources and the Investment Position

22. The application of resources (capital receipts, reserves etc.) to either finance capital expenditure or to support the revenue budget will have an ongoing impact on investments unless resources are supplemented each year from new sources (asset sales etc.). Detailed below are estimates of the year end balances for each resource and anticipated day to day cash flow balances.

Year End Resources	2015/16 Actual £m	2016/17 Revised £m	2017/18 Estimate £m	2018/19 Estimate £m	2019/20 Estimate £m
Fund balances	4.000	4.000	4.000	4.000	4.000
Capital receipts unapplied	0	0	0	0	0
Earmarked reserves	34.488	23.992	16.434	13.570	10.393
Earmarked reserves – regional	0.865	0.500	0.500	0.500	0.500
Provisions	1.096	1.000	1.000	1.000	1.000
Unapplied Capital Grants	9.308	2.720	-	-	-
Total Core Funds	**49.757**	**32.212**	**21.934**	**19.070**	**15.893**
Working Capital*	(5.925)	(3.000)	(3.000)	(3.000)	(3.000)
Under Borrowing	(9.651)	(9.672)	(9.709)	(9.932)	(10,036)
Expected Investments at year end	**34.181**	**19.540**	**9.225**	**6.138**	**2.857**

*Working capital balances shown are estimated year end; these may be higher at various points throughout the year and the average will be considerably higher. The revenue budget will reflect the estimated interest received on the average cash balance.

23. The table above shows that under borrowing is estimated at £9.7m in 2017/18.

24. Whilst interest rates available on investments remains low and the Commissioner's longer term cash flow is favourable, it is cost-effective to use our own resources to fund capital expenditure at least in the short term. This means that although we are planning to take out additional external borrowing for new investment, we will not replace

our current internal borrowing at the present time. If however we need to use more of our internal resources than currently forecast, we may eventually reach the point where we need to borrow to replenish the resources that we have used temporarily to fund our previous capital programme. This will be kept under review. The table above suggests we will not need to do this until 2019/20 at the earliest due to the underlying cash position.

Affordability Prudential Indicators

25. The previous sections cover the overall capital and control of borrowing prudential indicators, but within this framework prudential indicators are required to assess the affordability of the capital investment plans. These provide an indication of the impact of the capital investment plans on the Commissioner's overall finances.

26. **The ratio of financing costs to net revenue stream** – This indicator identifies the trend in the cost of capital (borrowing and other long-term obligation costs, net of investment income) against the net revenue stream. The indicator includes the cost of capital for PFI schemes.

	2015/16 Actual £m	**2016/17 Revised £m**	**2017/18 Estimate £m**	**2018/19 Estimate £m**	**2019/20 Estimate £m**
Cost of Capital (1)	2.550	2.690	2.542	2.735	2.793
Investment Income (2)	(0.221)	(0.148)	(0.076)	(0.076)	(0.076)
Financing Costs(1)-(2)	2.329	2.542	2.466	2.659	2.717
Net Revenue Stream based on 1.99% Council Tax increase	161.507	162.792	163.247	163.133	163.734
Percentage	1.44%	1.56%	1.51%	1.63%	1.66%

27. The estimates of financing costs include current commitments and any arising from the capital programme. Investment income has been affected by the economic climate, the fall in interest rates and the more cautious approach to the treasury strategy.

28. Although the expected borrowing in 2018/19 and 2019//20 will increase financing costs, they will continue to represent a relatively small proportion of the Commissioner's net revenue stream.

29. **The incremental impact of capital investment decisions on the Police Precept** – This indicator identifies the revenue costs associated with proposed changes to the three year capital programme compared to the existing approved commitments and current plans. The assumptions are based on the capital programme, but will invariably

include some estimates, such as the level of Government support, which are not published over a three year period.

30.

Police Precept – Band D	**Revised Budget 2016/17 £**	**Forward Projection 2017/18 £**	**Forward Projection 2018/19 £**	**Forward Projection 2019/20 £**
(i) Existing Commitments	2.69	2.51	1.78	1.27
(ii) Above plus SCE	2.69	2.51	1.78	1.27
(iii) Above plus unsupported borrowing	2.69	2.51	2.76	4.17
(iv)Difference between (iii) and (i)	0.00	0.00	0.98	2.90

Notes

- Changes to RCCO have been excluded.

31. 2018/19 and 2019/20 reflects the costs of unsupported borrowing anticipated for those years. It is considered that the level of capital expenditure and associated borrowing is affordable and prudent.

Treasury Management Strategy 2017/18 – 2019/20

1. The treasury management service is an important part of the overall financial management of the Commissioner's affairs. The prudential indicators in Appendix A consider the affordability and impact of capital expenditure decisions, and set out the Commissioner's overall capital framework. The treasury service considers the effective funding of these decisions. Together they form part of the process which ensures that the balanced budget requirement under the Local Government Finance Act 1992 is met. This broadly means ensuring that cash expenditure during the year is covered by cash raised.

2. The Commissioner's treasury activities are strictly regulated by statutory requirements and a professional code of practice (the CIPFA Code of Practice on Treasury Management). This organisation adopted the Code of Practice on Treasury Management in January 2013.

3. As a result of adopting the Code the organisation also adopted a Treasury Management Policy Statement (January 2013). This adoption is the requirements of one of the prudential indicators.

4. CIPFA defines treasury management as:-

   "The management of the [PCC's] investments and cash flows, his banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."

5. The Commissioner is required to receive and approve, as a minimum, three main reports each year

   - **The annual Prudential and treasury indicators and treasury strategy** (this report) outlining the expected treasury activity for the forthcoming 3 years. A key requirement of this report is to explain both the risks, and the management of the risks, associated with the treasury service.

   - **A mid year treasury management report**. This provides an update on progress against the indicators and on treasury management performance. Monitoring reports will usually be taken to the Strategic Governance Board twice a year.

   - **An annual treasury management report.** This provides details of a selection of actual prudential and treasury indicators and Actual treasury operations compared to estimates within the strategy. The annual report is taken to the Strategic Governance Board in June.

6. This annual strategy covers:

   - The Commissioner's debt and investment projections;
   - The estimates and limits on future debt levels (limits to borrowing);
   - The expected movement in interest rates;
   - The Commissioner's borrowing and investment strategies;

- Treasury performance indicators;
- Specific limits on treasury activities;

Debt and Investment Projections 2017/18 – 2019/20

7. The Commissioner's treasury portfolio position at 31 March 2016, with forward projections to 31 March 2020 are summarised below. The table below shows the actual external debt (the treasury management operations) against the underlying capital borrowing need (the Capital Financing Requirement – CFR), highlighting any over or under borrowing.

	2015/16 Actual £m	2016/17 Revised £m	2017/18 Estimated £m	2018/19 Estimated £m	2019/20 Estimated £m
External Debt					
Debt at 1 April	6.557	6.011	5.465	4.920	12.803
Expected change in debt	(0.546)	(0.546)	(0.545)	7.883	0.978
Other Long Term Liabilities	12.022	11.123	10.254	9.214	8.489
Gross Debt at 31 March	**18.033**	**16.588**	**15.174**	**22.017**	**22.270**
CFR	27.684	26.260	24.883	31.949	32.306
Under/ (over) borrowing	9.651	9.672	9.709	9.932	10.036

8. Within the prudential indicators there are a number of key indicators to ensure that the Commissioner operates within well-defined limits.

9. One of these is that the Commissioner needs to ensure that total gross debt does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2016/17 and the following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes.

10. The Chief Finance Officer reports that the Commissioner complied with this prudential indicator in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans, and the proposals in the capital programme report.

Treasury Indicators - Limits to Borrowing Activity

11. **The Operational Boundary.** This is the limit beyond which external debt is not normally expected to exceed during the course of the year. It is not an actual limit and borrowing could vary around this boundary

for short times during the year. The limit is set using the start of year external debt figures plus a contingency for the overdraft limit plus long term liabilities (PFI).

Operational Boundary	**2016/17 Revised £m**	**2017/18 Estimate £m**	**2018/19 Estimate £m**	**2019/20 Estimate £m**
Borrowing	7.9	7.3	13.9	14.8
Other long term liabilities	11.1	10.3	9.2	8.5
Total	**19.0**	**17.6**	**23.1**	**23.3**

The Operational Boundary estimates are currently substantially below the Capital Financing Requirement. This reflects the use of internal borrowing to fund parts of the Capital Programme in previous years. As and when external borrowing replaces the use of internal funds, the Operational Boundary will move closer to the CFR.

12. **The Authorised Limit for External Debt –** A further key prudential indicator represents a control on the overall maximum level of borrowing. This represents a limit beyond which external debt is prohibited, and this limit needs to be set or revised by the Commissioner. It reflects the level of external debt which, while not desired, could be afforded in the short term but is not sustainable in the longer term.
13. The Authorised Limit is the statutory limit determined under section 3 (1) of the Local Government Act 2003. The Government retains an option to control either the total of all Authorities' plans, or those of a specific Authority, although no control has yet been exercised.
14. The Commissioner is asked to approve the following Authorised Limit:

Authorised limit	**2016/17 Revised £m**	**2017/18 Estimate £m**	**2018/19 Estimate £m**	**2019/20 Estimate £m**
Borrowing	15.5	13.4	21.4	22.3
Other long term liabilities	11.1	10.3	9.2	8.5
Total	26.6	23.7	30.6	30.8

15. The figures for the proposed authorised limit for 2017/18 take into account:

(a) The estimated amount of outstanding borrowing approvals on capital expenditure at 31 March 2017 (£5.185m) plus outstanding borrowing of £0.280m regarding transferred debt from Derbyshire

County Council and Derby City Council which arose upon reorganisation.

(b) Any new external borrowing for capital schemes during 2017/18 (no external borrowing is planned in this year) less the estimated amount for debt redemption within 2017/18 loan charges (£0.546m).

(c) The amount of any short-term borrowing pending receipt of grant on capital schemes. The estimated maximum figure for 2017/18 is £0.5m.

(d) The amount of any short-term borrowing pending receipt of revenue income. This should be minimal, but in order to cover any unforeseen changes in cash flow patterns (for example the timing of receipt of Government Grants in 2017/18), it is suggested a figure of £8m be used.

(e) The figure for other long-term liabilities is an allowance for items such as the capital value of qualifying property leases or finance leases which may arise. The figure for 2017/18 includes £10.254m for PFI Liabilities.

16. Based on the above, it is proposed that the authorised limit for outstanding debt should be set at £23.7m for 2017/18. Proposed limits for future years have been calculated in a similar manner taking into account the anticipated future borrowing requirements from 2018/19.

Expected Movement in Interest Rates

17. The Commissioner has appointed Capita Asset Services as his treasury advisor and part of their service is to assist him to formulate a view on interest rates. The following table gives the Sector central view.

Annual Average %	Bank Rate	Money Rates		PWLB Borrowing Rates		
		3 month	1 year	5 year	25 year	50 year
Mar 2017	0.25	0.50	0.90	1.60	2.90	2.70
June 2017	0.25	0.50	1.00	1.60	2.90	2.70
Sept 2017	0.25	0.60	1.10	1.60	2.90	2.70
Dec 2017	0.25	0.80	1.30	1.60	3.00	2.80
Mar 2018	0.25	0.90	1.40	1.70	3.00	2.80
June 2018	0.25	1.10	1.50	1.70	3.00	2.80
Sept 2018	0.25	1.10	1.60	1.70	3.10	2.90
Dec 2018	0.25	1.30	1.80	1.80	3.10	2.90
Mar 2019	0.25	1.40	1.90	1.80	3.20	3.00
June 2019	0.50	1.50	2.00	1.90	3.20	3.00
Sept 2019	0.50	1.80	2.30	2.00	3.30	3.10
Dec 2019	0.75	1.90	2.40	2.00	3.30	3.10
Mar 2020	0.75	2.10	2.60	2.00	3.40	3.20

UK. The Monetary Policy Committee (MPC) cut the Bank Rate from 0.5% to 0.25% in August 2016 in order to counteract a forecasted sharp slowdown in growth in the second half of the year. It also gave a strong steer that further cuts to the Rate would be implemented before the end of the year.

In the event, the Bank Rate was not cut further as economic data since August has indicated that growth in the second half of 2016 has been much stronger than anticipated. The decision to maintain the rate at 0.25% was also influenced by higher forecasts for inflation, as a result of recent falls in the value of sterling. Further cuts in the near term now appear unlikely, although this could change if economic growth was to dip significantly.

On the other hand it is unlikely that the Rate will be increased over the next two years, 2017/2019. During this period the UK will be negotiating its withdrawal from the EU and the MPC will not want to do anything to dampen economic growth at a time when the uncertainties over the terms of Brexit are already expected to have an adverse impact. Consequently, Capita are not forecasting an increase back to 0.5% until Q2 of 2019 and then only tentatively. An increase could be delayed further if, say, Brexit negotiations were extended or brought forward if domestic inflation were to rise significantly.

In summary, economic and interest rate forecasting remains difficult with so many external influences weighing on the UK

The forecast longer run trend for borrowing costs is for rates to start to rise, albeit gently. Rates fell sharply to historically low levels following the EU referendum and then fell even further after the August 2016 meeting of the MPC which announced a new quantitative easing package around the purchase of gilts.

Gilt yields have since risen sharply due to a rise in concerns about a ‘hard’ Brexit, the fall in the value of sterling, and an increase in inflation expectations. The policy of avoiding new borrowing by running down spare cash balances has served well over the last few years. However this strategy needs to carefully monitored to avoid incurring higher borrowing costs in later times when new borrowing may be necessary to finance projects within the capital programme.

There will remain a cost of carry to any new borrowing which causes a temporary increase in cash balances as this will incur a revenue cost – the difference between borrowing costs and investment returns

Borrowing Strategy 2017/18 – 2019/20

18. The Commissioner is currently maintaining an under-borrowed position. This means that the capital borrowing need (the Capital Financing Requirement), has not been fully funded with loan debt as the cash supporting reserves, balances and cash flow has been used to pay for capital expenditure as a temporary measure. This strategy is

prudent as investment returns are low and counterparty risk is still of concern

19. This policy also relies on the availability of internal resources and this will be kept under review as more work is done on identifying revenue requirements, in particular to address the existing and emerging policing risk gap as well as funding required for new capital projects.

20. Against this background and the risks within the economic forecast – especially the uncertainty over future interest rates – caution will be adopted with the treasury management operations in 2017/18. As a result the Commissioner will take a pragmatic approach to its treasury strategy, enabling him to respond to either of 2 scenarios:

    - if it is assessed that there is a significant risk of a sharp **fall** in long and short-term rates (eg. due to a marked increase of risks around relapse into recession or of risks of deflation), then further long-term borrowing will be postponed
    - if it is assessed that there is a significant risk of a much sharper **rise** in long and short-term rates than that currently forecast then the borrowing position may be re-assessed with a view to taking out new borrowing before the interest rates rises take effect. This may occur in advance of need, in terms of relevant expenditure within the Capital Programme. In such a case, a clear business case would be presented to support this course of action.

21. It is currently assumed that no external borrowing will take place during 2017/18. However, there is an anticipated shortfall on the proposed Capital Programme for 2018/20 which may well require new borrowing to be taken out.

22. The main source of new loans has previously been the Public Works Loans Board (PWLB), and it is estimated that all of the Commissioner's borrowing requirements could be sourced from here. Historically the PWLB has offered the lowest rates. However the banking sector may be competitive from time to time. Consequently it is recommended that the approved source of borrowing should be both the PWLB and the London Money Market.

23. In 2012/13 the Government introduced the 'certainty rate' discount on PWLB loans which enables eligible local authorities to access cheaper borrowing. This gives a 20 basis points discount on loans from the PWLB. Borrowing would have to feature in the force's long-term plans in order for it to qualify for this discount.

24. **Policy on borrowing in advance of need.** The Commissioner will not borrow more than, or in advance of, its needs purely to benefit from the investment of extra sums borrowed. As stated above, any decision to borrow in advance will be within approved Capital Financing Requirement estimates and will be considered carefully to ensure that value for money can be demonstrated and security of such funds be obtained.

25. **Debt Rescheduling/Repayment** – Consideration will be given to rescheduling or repayment of debt prematurely. Any savings from rescheduling/repayment of debt would have to be considered in the light of the current treasury position and the size of the cost of debt repayment (premiums incurred). No such rescheduling or early repayment is currently planned during the period covered by this report.

Treasury Management Limits on Activity

26. There are three further debt related treasury activity limits. The purpose of these are to contain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of an adverse movement in interest rates. However if these are set at too restrictive a level they will impair the opportunities to reduce costs and/or improve performance*.* The indicators are:

27. **Upper limits on variable and fixed interest rate exposure**

Recommended upper limits on the percentage of borrowing and investments held at fixed and variable rates, as required by the Code, are set out below:

	2017/18 Upper	**2018/19 Upper**	**2019/20 Upper**
Borrowing			
Limits on fixed interest rates	100%	100%	100%
Limits on variable interest rates	30%	30%	30%
Investments			
Limits on fixed interest rates	20%	20%	20%
Limits on variable interest rates	100%	100%	100%

For investments, fixed interest rates are deemed to apply to loans for more than one year.

Limits set at these levels will provide for efficient debt management, within an acceptable degree of risk. For the purposes of the Code, investments are to be deducted from borrowing to produce adjusted limits, but within the above parameters.

28. **Maturity structures of borrowing**

The maturity profile is the rate at which long-term loans have to be repaid to the PWLB (or other lenders). It would be imprudent to have a large proportion of repayments in any one year, thus a spread of redemption is desirable.

Currently most of the Commissioner's loan debt is repayable over a period of 25 years. One loan is repayable on maturity.

The maturity structure is a prudential indicator under the Code, with lower and upper limits recommended as shown in the table below.

Maturity Structure of fixed interest rate borrowing			
		2017/18	**Currently**
Under 12 months	Lower-Upper	0%-10%	9.0%
12 months to 2 years	Lower-Upper	0%-10%	9.0%
2 years to 5 years	Lower-Upper	0%-30%	26.5%
5 years to 10 years	Lower-Upper	0%-45%	41.6%
10 years and above	Lower-Upper	10%-90%	14.0%

Investment Strategy 2017/18 – 2019/20

29. **Investment Policy -** The Commissioner's investment policy has regard to the CLG's Guidance on Local Government Investments ("the Guidance") and the revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code"). The Commissioner's primary objectives are: first – security, meaning safeguarding the repayment of the principal and interest of his investments on time; and second - ensuring adequate liquidity. The investment return obtainable is then a third objective.

30. In accordance with the above guidance from the CLG and CIPFA, and in order to minimise the risk to investments, the Commissioner applies minimum acceptable credit criteria to create a list of highly creditworthy counterparties for inclusion on the lending list. This enables diversification and thus avoidance of concentration risks

31. The Commissioner's officers recognise that ratings should not be the sole determinant of the quality of an institution and that it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets.

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

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

34. Investment instruments identified for use in the financial year are listed in Appendix B1 under the 'Specified' and 'Non-Specified' Investments categories.

Creditworthiness policy

35. The primary principle governing the Commissioner's investment criteria is the security of its investments, although the yield or return on the investment is also a key consideration. After this main principle the Commissioner will ensure:

- He maintains a policy covering both the categories of investment types he will invest in, criteria for choosing investment counterparties with adequate security, and monitoring their security.
- He has sufficient liquidity in his investments. For this purpose he will set out procedures for determining the maximum periods for which funds may prudently be committed. These procedures also apply to the prudential indicators covering the maximum principal sums invested.

36. The Chief Finance Officer will maintain a counterparty list in compliance with the following criteria and will revise the criteria and submit them to the Commissioner for approval as necessary. These criteria are separate to those which determine Specified and Non-Specified investments (see Appendix B1) as they provide an overall pool of counterparties considered high quality that the PCC may use, rather than defining what types of investment instruments are to be used.

37. Credit rating information is supplied by Capita Asset Services, our treasury advisors, on all active counterparties that comply with the criteria below. Any counterparty failing to meet the criteria would be omitted from the counterparty list. Any rating changes are provided to officers almost immediately after they occur and this information is considered before dealing.

38. The criteria for providing a pool of high quality investment counterparties (both Specified and Non-specified investments) is:

- **Banks/Building Societies 1 - Good Credit Quality** – the Commissioner will only use UK banks and Building Societies which have, as a minimum, the following Fitch, Moody's and Standard and Poors credit ratings (where rated):
    1. **Short Term Rating-** F1 (or equivalent) from Fitch, Moody's (P-1) or S&P's (A-1)
    2. **Long Term Rating-** A (single A category) or equivalent from Fitch, Moody's or S&P's.
- **Banks 2** – Part nationalised UK bank - Royal Bank of Scotland. This bank can be included if it continues to be part nationalised or it meets the ratings in Banks 1 above.
- **Banks 3** - The Commissioner's own banker for transactional purposes if the bank falls below the above criteria, although in

this case balances will be minimised in both monetary size and time.

- **UK Government** (eg Debt Management Account Deposit Facility (DMADF))
- **Local Authorities**
- **Money Market Funds –** "AAA" rated by Fitch, Moody's and S&P

39. **Country and sector considerations** – the Commissioner will only invest in UK banks and building societies with the above ratings.

40. **Use of additional information other than credit ratings** Additional requirements under the Code require the Commissioner to supplement credit rating information. Whilst the above criteria rely primarily on the application of credit ratings to provide a pool of appropriate counterparties for officers to use, additional operational market information will be applied before making any specific investment decision. This additional market information (for example negative rating watches/outlooks) will be applied to compare the relative security of differing investment counterparties on the approved list.

41. **Time and Monetary Limits applying to Investments** – The time and monetary limits for institutions on the Commissioner's Counterparty List are as follows (these will cover both Specified and Non-Specified Investments):

	Fitch (or equivalent)	**Money Limit (group)**	**Time Limit**
Banks/Building Societies 1 - Upper Limit	*F1+ (S/T)* *AA- (L/T)*	£10m (£3m if > 365 days)	2yrs
Banks/Building Societies 1 – Middle Limit	F1 (S/T) A- (L/T)	£6m	1yr
Banks 2 Part nationalised banks	N/A	£10m	1yr
Banks 3 PCC's banker		£10m	1yr
Money Market Funds	AAA	£10m	1yr
Debt Management Account Deposit Facility		£35m	1yr
Local Authorities		£30m (£6m per	1yr

		authority)	

Note – In addition to the above on a temporary basis and subject to approval by the Treasurer or the Director of Finance an additional £2m (increases amount to £12m) can be invested with Barclays Bank for a maximum of 5 days

42. The proposed criteria for Specified and Non-Specified investments are shown in Appendix B1 for approval.

43. The use of longer term instruments (greater than one year from inception to repayment) will fall in the Non-specified investment category. These instruments will only be used where the Commissioner's liquidity requirements are safeguarded. This will also be limited by the longer term investment limits.

44. The list of counterparties (who currently meet these criteria) for approval is attached at Appendix B2 along with their current ratings and limits. Definitions of credit ratings are shown in Appendix B3.

Investment Strategy

45. **In house funds -** Investments will be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months).

46. **Investment returns expectations.** Bank Rate is forecast to stay flat at 0.25% until quarter 2 of 2019 and not rise above 0.75% by quarter 1 of 2020. Bank Rate forecasts for financial year ends (March) are:

    - 2016/17 0.25%
    - 2017/18 0.25%
    - 2018/19 0.25%
    - 2019/20 0.50%

    There are downside risks to these forecasts (i.e. start of increases in Bank Rate occurs later) if economic growth weakens. However, should the pace of growth quicken there could be upside risk.

    The criteria for choosing counterparties set out above provide a sound approach to investment in "normal" market circumstances. Whilst the Commissioner is asked to approve these base criteria, under the exceptional current market conditions the Treasurer may temporarily restrict further investment activity to those counterparties considered of higher credit quality than the minimum criteria set out for approval. These restrictions will remain in place until the banking system returns to "normal" conditions. Similarly the time periods for investments will be restricted.

Investment treasury indicator and limit

47. **Total principal funds invested for greater than 364 days**

These limits are set with regard to the Commissioner's liquidity requirements and to reduce the need for early sale of an investment, and are based on the availability of funds after each year end. A limit for lending for more than one year is set out below:

Maximum principal sums invested > 364 days			
£m	**2017/18**	**2018/19**	**2019/20**
Principal sums invested > 364 days	£3m	£3m	£3m

End of year investment report

48. At the end of the financial year, the Commissioner will report on his investment activity as part of his Annual Treasury Management report.

Policy on the use of external service providers

49. The Commissioner uses Capita Asset Services, Treasury Solutions as its external Treasury management advisors. The company provides a range of services which include:

- Technical support on treasury matters, capital finance issues and the drafting of reports;
- Economic and interest rate analysis;
- Debt services which includes advice on the timing of borrowing;
- Debt rescheduling advice surrounding the existing portfolio;
- Generic investment advice on interest rates, timing and investment instruments;
- Credit ratings/market information service comprising the three main credit rating agencies;

50. Whilst the advisers provide support to the internal treasury function, under current market rules and the CIPFA Code of Practice responsibility for the final decision on treasury matters remains with the organisation at all times.

51. The terms under which Capita Asset Services are employed and the services provided are properly agreed and documented, and are subject to regular review.

Treasury Management Practice (TMP) 1 – Credit and Counterparty Risk Management

The CLG issued Investment Guidance in 2010, and this forms the structure of the Commissioner's policy below. These guidelines do not apply to either trust funds or pension funds which are under a different regulatory regime.

The key intention of the Guidance is to maintain the current requirement for organisations to invest prudently, and that priority is given to security and liquidity before yield. In order to facilitate this objective the guidance requires that the Commissioner have regard to the CIPFA publication Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes. The Commissioner adopted the Code in January 2013 and will apply its principles to all investment activity. In accordance with the Code, the Treasury has produced its treasury management practices (TMPs). This part, TMP 1(5), covering investment counterparty policy requires approval each year.

Annual Investment Strategy - The key requirements of both the Code and the investment guidance are to set an annual investment strategy, as part of its annual treasury strategy for the following year, covering the identification and approval of following:

- The strategy guidelines for choosing and placing investments, particularly non-specified investments.
- The principles to be used to determine the maximum periods for which funds can be committed.
- The Specified investments the Commissioner will use, as defined below.
- Non-specified investments, clarifying the greater risk implications, identifying the general types of investment that may be used and a limit to the overall amount of various categories that can be held at any time.

The investment policy proposed for the Commissioner is:

Strategy Guidelines – The main strategy guidelines are contained in the body of the treasury strategy statement.

Specified Investments – These investments are sterling investments of not more than one-year maturity. These are considered low risk assets where the possibility of loss of principal or investment income is small. These would include sterling investments which would not be defined as capital expenditure with:

1. The UK Government (such as the Debt Management Account deposit facility, UK Treasury Bills or a Gilt with less than one year to maturity).
2. A local authority.
3. A body that is considered of a high credit quality (such as a bank or building society). For category 3 this covers bodies with a minimum short

term rating of F1 (or the equivalent) as rated by Fitch, Moody's (P-1) or Standard and Poor's (A-1) rating agencies.

4. Part nationalised UK banks, if they continue to be part nationalised or they meet the criteria in *(3)* above.

5. Money Market Funds that have been awarded a high credit rating (AAA) by Fitch, Moody's or Standard and Poor's rating agencies.

Within these bodies, and in accordance with the Code, the Commissioner has set additional criteria to set the time and amount of monies which will be invested in these bodies. These criteria are shown in paragraph 41 of Appendix B.

Non-Specified Investments – Non-specified investments are any other type of investment (i.e. not defined as Specified above). The Commissioner is required to look at non-specified investments in more detail. He must set out:

- procedures for determining which categories of non-specified investments should be used
- the categories deemed to be prudent
- the maximum amount to be held in each category

The Strategy must also set out procedures for determining the maximum period for committing funds.

It is recommended that the following procedure be adopted for determining which categories of non-specified investments should be used:

- the Commissioner should approve categories on an annual basis
- advice should be provided by the Treasurer to the Commissioner
- priority should be given to security and liquidity ahead of yield

On this basis the following categories of non-specified investments are currently considered as prudent and are recommended for use:

(a) investments in excess of 364 days but for not more than 2 years duration with counter-parties on the Commissioner's list provided that they have

Short Term - F1+ (or equivalent from Moody's and Standard & Poors)
Long Term – AA- or better (or equivalent from Moody's and Standard & Poors)

(b) the Commissioner's own banker if it fails to meet the basic credit criteria. In this instance balances will be minimised as far as is possible.

It is recommended that the limit for category (a) should be set at £1m per counterparty subject to an overall limit of £3m. Whilst most of the Commissioner's surpluses are of a temporary nature, others such as the insurance provision and PFI reserves could reasonably be invested for periods in excess of one year. These instruments will only be used where the Authority's liquidity requirements are safeguarded. For category (b) balances will be minimized as far as is possible in the event of the bank falling below the basic criteria.

The Monitoring of Investment Counterparties - The credit rating of counterparties will be monitored regularly. The Commissioner receives credit rating information from Capita Asset Services as and when ratings change, and counterparties are checked promptly. On occasion ratings may be downgraded when an investment has already been made. The criteria used are such that a minor downgrading should not affect the full receipt of the principal and interest. No further investment will be made with any counterparty failing to meet the criteria. If required, new counterparties which do meet the criteria will be added to the list under the delegated authority of the Treasury and any changes will be reported to a later Strategic Governance Board.

List of Approved Counterparties for Lending for Police & Crime Commissioner for Derbyshire.

Any values highlighted in yellow have undergone a change in the past 14 days.

			Fitch Ratings			Moodys Ratings			S&P Ratings									
Counterparty			Long Term	Short Term		Long Term	Short Term		Long Term	Short Term	Suggested Duration	(Watch/ Outlook Adjusted)	CDS Price	CDS Status	(CDS Adjusted with manual override)	Monetary Limit	Duration	Notes
United Kingdom		NO	AA		NO	Aa1		NO	AA				26.96					
AAA rated and Government backed	Debt Management Office										Y - 60 mths	Y - 60 mths			Not Applicable	35.00 Million	6 Months	(M)
Banks	Bank of Scotland PLC	SB	A+	F1	SB	A1	P-1	NO	A	A-1	R - 6 mths	R - 6 mths	64.87	●	R - 6 mths	6.00 Million	1 Years	
	Barclays Bank PLC	SB	A	F1	NO	A1	P-1	NO	A-	A-2	R - 6 mths	R - 6 mths	78.63	●	R - 6 mths	10.00 Million	1 Years	(M) Council's Bank
	Close Brothers Ltd	SB	A	F1	SB	Aa3	P-1				R - 6 mths	R - 6 mths			R - 6 mths	6.00 Million	1 Years	
	Goldman Sachs International Bank	SB	A	F1	SB	A1	P-1	SB	A+	A-1	R - 6 mths	R - 6 mths	88.33	●	R - 6 mths	6.00 Million	1 Years	
	HSBC Bank PLC	SB	AA-	F1+	NO	Aa2	P-1	NO	AA-	A-1+	O - 12 mths	O - 12 mths	67.40	●	O - 12 mths	10.00 Million	1 Years	£3 Mln/2 Yrs
	Lloyds Bank Plc	SB	A+	F1	SB	A1	P-1	NO	A	A-1	R - 6 mths	R - 6 mths	67.89	●	R - 6 mths	10.00 Million	1 Years	(M)
	Santander UK PLC	PO	A	F1	NO	Aa3	P-1	NO	A	A-1	R - 6 mths	R - 6 mths			R - 6 mths	6.00 Million	1 Years	
	Standard Chartered Bank	SB	A+	F1	NO	Aa3	P-1	SB	A	A-1	R - 6 mths	R - 6 mths	114.27	●	G - 100 days	6.00 Million	1 Years	
	Sumitomo Mitsui Banking Corporation Europe Ltd	NO	A	F1	SB	A1	P-1	PO	A	A-1	R - 6 mths	R - 6 mths	51.69	●	R - 6 mths	6.00 Million	1 Years	
	UBS Ltd.	SB	A+	F1	SB	A1	P-1	SB	A+	A-1	R - 6 mths	R - 6 mths	61.17	●	R - 6 mths	6.00 Million	1 Years	
Building Society	Coventry Building Society	SB	A	F1	NO	A2	P-1				R - 6 mths	R - 6 mths			R - 6 mths	6.00 Million	1 Years	
	Leeds Building Society	SB	A-	F1	NO	A2	P-1				R - 6 mths	R - 6 mths			R - 6 mths	6.00 Million	1 Years	
	Nationwide Building Society	PO	A	F1	NO	Aa3	P-1	NO	A	A-1	R - 6 mths	R - 6 mths			R - 6 mths	6.00 Million	1 Years	
Nationalised and Part Nationalised Banks	National Westminster Bank PLC	SB	BBB+	F2	PO	A3	P-2	SB	BBB+	A-2	B - 12 mths	B - 12 mths			Not Applicable	10.00 Million	1 Years	(M)
	The Royal Bank of Scotland Plc	SB	BBB+	F2	PO	A3	P-2	SB	BBB+	A-2	B - 12 mths	B - 12 mths	112.09	●	Not Applicable	10.00 Million	1 Years	(M)

Please note that the Capita suggested methodology applies a minimum sovereign criteria of “AA-”. In instances where individual client criteria allows for the potential use of entities from lower rated sovereigns, suggested duration columns in these lists may show a “colour”, but this will purely be based on the ratings / CDS of the individual entity. It will not take account of the sovereign rating, which alone may provide a reason for it not being included within the Capita suggested list of counterparties.

Advisory notes:

Local Authorities - 1 Year - £30 Million / £6 Million per LA

As per Capita, Lloyds Bank are no longer classed as Part Nationalised so their limit will reduce from £10m to £6m

Key

Watches and Outlooks

SB	Stable Outlook
NO	Negative Outlook
NW	Negative Watch
PO	Positive Outlook
PW	Positive Watch
EO	Evolving Outlook
EW	Evolving Watch
WD	Rating Withdrawn

CDS

Indicator	Status
●	In Range
●	Monitoring
●	Out of Range

Duration

60 Months	Y
24 Months	P
12 Months	B
12 Months	O
6 Months	R
100 Days	G
0 Months	N/C

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Credit Ratings

<u>Definition - Short-Term Bank Deposit Ratings (Fitch)</u>

F1 - Highest credit quality.
Indicates the strongest capacity for timely payment of financial commitments; may have an added '+' to denote any exceptionally strong credit feature.

F2 - Good credit quality.
A satisfactory capacity for timely payment of financial commitments, but the margin of safety is not as great as in the case of the higher ratings.

F3 - Fair credit quality.
The capacity for timely payment of financial commitments is adequate; however, near term adverse changes could result in a reduction to non-investment grade.

B - Speculative.
Minimal capacity for timely payment of financial commitments, plus vulnerability to near term adverse changes in financial and economic conditions.

C - High default risk.
Default is a real possibility. Capacity for meeting financial commitments is solely reliant upon a sustained, favourable business and economic environment.

D - Default.
Indicates an entity or sovereign that has defaulted on all of its financial obligations.

<u>Definition - Long-Term Bank Deposit Ratings (Fitch)</u>

AAA – Highest credit quality.
'AAA' ratings denote the lowest expectation of credit risk. They are assigned only in case of exceptionally strong capacity for payment of financial commitments. This capacity is highly unlikely to be adversely affected by foreseeable events.

AA – Very high credit quality.
'AA' ratings denote expectations of very low credit risk. They indicate very strong capacity for payment of financial commitments . This capacity is not significantly vulnerable to foreseeable events.

A – High credit quality.
'A' ratings denote expectations of low credit risk. The capacity for payment of financial commitments is considered strong. This capacity may, nevertheless, be more vulnerable to changes in circumstances and economic conditions than is the case for higher ratings. Susceptibility to long term risks appears somewhat greater.

BBB - Good credit quality.
'BBB' ratings indicate that there are currently expectations of low credit risk. The capacity for payment of financial commitments is considered adequate but adverse changes in circumstances and economic conditions are more likely to impair this capacity. This is the lowest investment grade category.