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.