



**Report of the Chief Financial Officer for the Police and Crime Commissioner (PCC) to the PCC
28th February 2018**

Status: For Decision

Treasury Management and Prudential Indicators 2018/22

1. Purpose

To comply with the CIPFA Prudential Code of Practice, the PCC is required to set a range of Prudential Indicators for the financial year 2018/19. The code states that Prudential Indicators for Treasury Management should be considered together with the Annual Investment Strategy for 2018/19. The content of this report addresses this requirement.

2. Recommendations

The PCC is asked to:

- 2.1 Approve the Prudential Indicators, set out in 3.5, 3.6 and 3.7.
- 2.2 Approve the Annual Investment Strategy set out at Appendix A.
- 2.3 Note that future investments will be placed in line with the strategy in Appendix A.

3. Reasons

3.1 Prudential Indicators

The Prudential Code requires authorities (including the PCC) to self regulate the affordability, prudence and sustainability of their capital expenditure and borrowing plans, by setting estimates and limits, and by publishing actuals, for a range of Prudential Indicators. It also requires them to ensure their Treasury Management Practices are in accordance with good practice.

3.2 The Code imposes on authorities clear governance procedures for setting and revising of Prudential Indicators, and describes the matters to which an authority will have regard when doing so. This is designed to deliver accountability in taking capital financing, borrowing and Treasury Management decisions. A fundamental provision of the Prudential Code is that over the medium term net borrowing will only be for a capital purpose.

3.3 Under the Code, individual authorities are responsible for deciding the level of their affordable borrowing, having regard to the code. Under the code the PCC is required to set a range of Prudential Indicators for the financial year 2018/19.

3.4 The code states that Prudential Indicators for Treasury Management should be considered together with the Annual Investment Strategy.

3.5 Affordability

The following indicators are required to assess the affordability of the capital investment plans. They provide an indication of the impact of the capital investment plans on overall PCC finances. The PCC is requested to approve the following:

3.5.1 Ratio of Financing Costs to Net Revenue Stream

This indicator identifies the trend in the cost of capital against the net budgetary requirement. In effect it is looking at how much of the revenue budget needs to be set aside for the funding of capital decisions and how sustainable this is going forward.

	2017/18	2018/19	2019/20	2020/21	2021/22
Financing Costs to Net Revenue Streams	Estimate	Estimate	Estimate	Estimate	Estimate
	£000	£000	£000	£000	£000
Minimum Revenue Provision (MRP)	189	442	616	616	706
Interest Payable on Borrowing	4	275	275	275	275
Interest Receivable	(100)	(35)	(35)	(35)	(35)
Financing Costs	93	682	856	856	946
Net Revenue Stream	141,689	145,320	149,521	153,091	156,749
Ratio %	0.1%	0.5%	0.6%	0.6%	0.6%

While the percentage of the net revenue stream needed to be set aside to fund financing costs is expected to increase during 2018/19 it is still projected to

remain below 1% of the overall budget and therefore shouldn't provide any long terms problems in terms of affordability and sustainability.

It is worth bearing in mind that a significant proportion of the Capital Expenditure is funded from revenue contributions to Capital. If future budgets can't accommodate these continued contributions through to 2021/22, then this would have a significant impact on either the ability of the organisation to continue with the investment plans and/or it would have to significantly increase planned levels of borrowing. This in turn would impact on this calculation and would ultimately increase the amount of the revenue budget that would need to be set aside to fund financing costs.

3.5.2 Incremental Impact of Capital Investment Decisions on Band D Council Tax

This indicator shows the incremental impact of the additional capital expenditure that is planned in the current programme on the Band D council tax.

Council Tax	2017/18	2018/19	2019/20	2020/21	2021/22
	Estimate	Estimate	Estimate	Estimate	Estimate
	£	£	£	£	£
Band D Impact on Capital	(0.10)	1.64	0.49	0.00	0.20
Band D increase year on year	4.32	11.50	12.00	4.87	4.97
%age of Precept increase to fund additional Capital	-2.3%	14.3%	4.0%	0.0%	4.0%

The PCC has approved an £11.50 increase in the Band D Precept for 2018/19. Of this increase 14.3% will be funding increases in capital financing costs over the amount of funding that was set aside for Capital Purposes in 2017/18. The main reason for the increase relates to the timing of the need to borrow to fund the move to Alverton Court and more over the need to borrow to fund the capital programme.

Now that Capital Reserves have been used then how Capital expenditure is funded going forward is going to extremely important as there is a direct impact now on the revenue budget for any decision to borrow beyond what it currently included within the current MTFP.

3.6 Prudence

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The 'prudence' indicator generally looks at the level of borrowing needed to maintain the current plans of the organisation.

Capital Expenditure	2017/18	2018/19	2019/20	2020/21	2021/22
	Estimate	Estimate	Estimate	Estimate	Estimate
	£000	£000	£000	£000	£000
Capital Expenditure	11,343	8,128	6,666	5,760	4,658
Total Capital Expenditure	11,343	8,128	6,666	5,760	4,658
Funded By:					
Gross Borrowing	8,500	4,000	1,799	250	47
Leasing	0	0	0	0	0
%age of Expenditure funded by Borrowing	74.9%	49.2%	27.0%	4.3%	1.0%

Based on the current plans, the forecast significant level of borrowing required in the next couple of year shouldn't provide too much concern and it is all affordable within current plans. It is important to recognise that borrowing beyond these levels will incur additional revenue costs and the organisation should think very carefully before doing this.

3.6.1 The PCC's Borrowing Need (The Capital Financing Requirement)

The Capital Financing Requirement (CFR) measures the PCC's underlying need to borrow for Capital purposes and ensures that borrowing is only undertaken to fund capital assets and not support revenue expenditure.

The PCC is asked to approve the following CFR projections:

Capital Financing Requirement	2017/18	2018/19	2019/20	2020/21	2021/22
	Estimate	Estimate	Estimate	Estimate	Estimate
	£000	£000	£000	£000	£000
Opening Capital Financing Requirement	2,673	10,984	14,542	15,724	15,359
Unsupported borrowing to fund Capital Expenditure	8,500	4,000	1,799	250	47
Total CFR Base on which MRP is calculated	11,173	14,984	16,340	15,975	15,405
MRP on Borrowing	(189)	(442)	(616)	(616)	(706)
Total CFR Base for borrowing purposes	10,984	14,542	15,724	15,359	14,699

The Borrowing (both Internal and External) included within the plans increases the Capital Financing Requirement (CFR). The PCC is required to make a statutory charge to revenue for the repayment of debt (the Minimum Revenue Provision) and this reduces the CFR.

3.6.2 Limits to Borrowing Activity

Within the Prudential indicators there are a number of indicators to ensure that the PCC operates its activities within well defined limits.

For the first of these the PCC needs to ensure that its total borrowing net of any investments 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 2018/19 and the following two financial years. This allows some flexibility for

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limited early borrowing for future years, to take advantage of market opportunities and to build in budget uncertainty.

Net Borrowing and the Capital Financing Requirement (CFR)	2017/18	2018/19	2019/20	2020/21	2021/22
	Estimate	Estimate	Estimate	Estimate	Estimate
	£000	£000	£000	£000	£000
Borrowing	7,000	10,750	10,750	10,300	9,850
Investments	(11,395)	(13,192)	(11,456)	(10,723)	(10,426)
Net Borrowing	(4,395)	(2,442)	(706)	(423)	(576)
Total CFR Base for borrowing purposes	10,984	14,542	15,724	15,359	14,699

The CFR, as set out above, across all 5 years is forecast to be in excess of the 'net borrowing' of the organisation and therefore the PCC can be assured that any borrowing that is forecast to be taken out over the coming years would not be to support revenue expenditure.

3.6.3 A further two prudential indicators control or anticipate the overall level of borrowing. These are:

- The **Authorised Limit** which represents the limit beyond which borrowing is prohibited and needs to be set and revised by the PCC, borrowing beyond this limit would be ultra vires.
- The **Operational Boundary** which is based on the probable external debt during the course of the year. It can include scope for borrowing for revenue purposes that may be required in the short term during the year, if for instance a large grant payment was delayed. However at this point no allowance for this has been made.

The PCC is asked to approve the following limits:

Authorised Limit for External Debt	2017/18	2018/19	2019/20	2020/21	2021/22
	Estimate	Estimate	Estimate	Estimate	Estimate
	£000	£000	£000	£000	£000
Borrowing	7,000	10,750	10,750	10,300	9,850
Provision for Temporary Borrowing	3,000	3,000	3,000	3,000	3,000
	10,000	13,750	13,750	13,300	12,850
Operational Boundary for External Debt	2017/18	2018/19	2019/20	2020/21	2021/22
	Estimate	Estimate	Estimate	Estimate	Estimate
	£000	£000	£000	£000	£000
Borrowing	7,000	10,750	10,750	10,300	9,850
Provision for Temporary Borrowing	0	0	0	0	0
	7,000	10,750	10,750	10,300	9,850

3.7 Treasury Management Indicators

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The purpose of these is to contain the activity of the Treasury function within certain limits, thereby reducing the risk or likelihood of an adverse movement in interest rates or borrowing decisions impacting negatively on the PCC's overall financial position. The PCC is asked to approve the indicators below:

3.7.1 Upper Limits on Borrowing

This indicator identifies a maximum level of borrowing that can be made at Fixed and Variable interest rates.

Borrowing	2017/18	2018/19	2019/20	2020/21	2021/22
	Estimate	Estimate	Estimate	Estimate	Estimate
	%	%	%	%	%
Upper Limit on Fixed Interest Rate Exposures	100	100	100	100	100
Upper Limit of Variable Rate Exposures	50	50	50	50	50

This means 50%-100% of our borrowing will be at rates fixed until the loan is repayable, while no more than 50% will be at variable rates so liable to change at short notice.

3.7.2 Upper Limits on Investments

This indicator identifies a maximum level of investments that can be made at Fixed and Variable interest rates.

Investments	2017/18	2018/19	2019/20	2020/21	2021/22
	Estimate	Estimate	Estimate	Estimate	Estimate
	%	%	%	%	%
Upper Limit on Fixed Interest Rate Exposures	100	100	100	100	100
Upper Limit of Variable Rate Exposures	50	50	50	50	50

This means 50%-100% of our investments will be at rates fixed until the investment matures, while no more than 50% will be at variable rates so liable to change at short notice.

3.7.3 Maturity Structure of Debt

These gross limits are set to reduce the PCC's exposure to large fixed rate sums falling due for re-financing within a short timeframe. Upper and lower limits are required which the PCC is asked to approve.

Maturity Structure of Debt	2017/18		2018/19		2019/20		2020/21		2021/22	
	Lower	Upper	Lower	Upper	Lower	Upper	Lower	Upper	Lower	Upper
Under 12 months	0%	50%	0%	50%	0%	50%	0%	50%	0%	50%
Over 12 months and under 2 years	0%	50%	0%	50%	0%	50%	0%	50%	0%	50%
Over 2 years and under 5 years	0%	50%	0%	50%	0%	50%	0%	50%	0%	50%
Over 5 years and under 10 years	0%	75%	0%	75%	0%	75%	0%	75%	0%	75%
Over 10 years	0%	100%	0%	100%	0%	100%	0%	100%	0%	100%

As the PCC moves into a position of having external debt then it becomes important to consider the timeframes under which these loans are taken out, when they will be re-paid and how this aligns with other debt repayments to

ensure that all loans don't fall due for repayment at the same time or require re-financing at the same time, when interest rates might be higher than long term averages.

3.7.4 Upper Limit for Sums Invested for a Period of over 364 days

This indicator sets a limit on the level of investments that can be made for more than 364 days. The PCC does not provide approval to invest beyond a 1 year period and at this stage it is not currently proposed to change this proposal

3.8 Annual Investment Strategy

The proposed Annual Investment Strategy for 2018/2019 is attached at Appendix A.

3.9 Returns on Investments

While returns on investments are of secondary importance to the security of the sums invested, it is still important to consider the potential impact of approving the Investment Strategy put forward. The limited number of counterparties on our list previously has restricted the returns, in the form of interest receivable, which the PCC could make. It is proposed within the Investment Strategy that fewer restrictions are put in place, but not at expense of taking unnecessary risks

3.10 Given the current low level of interest rates, the Bank of England Base rate is currently 0.5% and has been at 0.5% or below for almost 9 years, the impact will be relatively small. The budget set for interest receivable in 2018/19 is £35k.

3.11 Counterparty Limits

As per the strategy in Appendix A, limits for specified counterparties are:

- The maximum investment with any counterparty is £10 million.
- The maximum investment in any one group (i.e. a bank and its wholly-owned subsidiaries) is £15 million.

3.12 For non-specified counterparties these are:

- The maximum investment with any counterparty is £7 million.
- The maximum investment in any one group (i.e. a bank and its wholly-owned subsidiaries) is £10 million.

4. Implications

4.1 Finance

There are no financial implications arising from this report that is not included above.

4.2 Diversity & Equal Opportunities

There are no issues arising from this report to bring to the PCC's attention.

4.3 Human Rights Act

There are no Human Rights Act implications arising from this report.

4.4 Sustainability

This report is part of the process to establish sustainable annual and medium term financial plans and maintain prudent financial management.

4.5 Risk

The investment strategy put forward today seeks to minimise the risks of the PCC while ensuring that the cash balances of the PCC are managed in line with proper practice and to ensure funds are available to make payments at the correct time.

5. Conclusions

5.1 To comply with the CIPFA Prudential Code of Practice the PCC is required to set a range of Prudential Indicators for the financial year 2018/19.

5.2 The CIPFA code does not set benchmark indicators. Each organisation must use its judgement when setting indicators.

5.3 Based on the indicators proposed above, the revenue budget, capital programme and associated financing are within prudent limits.

5.4 A prudent Investment Strategy has been put forward for approval that seeks to firstly secure the money being invested before secondly looking at rates of return.

Michael Porter
CFO for the PCC

Annual Investment Strategy

The Commissioner will have regard to the CLG's Guidance on Local Government Investments ("the Guidance") and the 2011 revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code"). The Commissioner's investment priorities are:

- the security of capital; and
- the liquidity of its investments.

The Commissioner will also aim to achieve the optimum return on investments commensurate with proper levels of security and liquidity. The Commissioner's risk appetite is low in order to give priority to security of investments.

The borrowing of monies purely to invest or on-lend and make a return is unlawful and the Commissioner will not engage in such activity.

Investment instruments are identified as either 'Specified' or 'Non-Specified' Investments. The Commissioner's available instruments are listed in the paragraph below. Counterparty limits will be as set through the Treasury Management Practices.

Limits and Definition of Specified Investments

It is proposed that the Annual Investment Strategy for 2018/19 is based upon the use of the "specified" investments listed below:

- The investment is made with the UK Government or a Local Authority (as defined in the Local Government Act 2003).
- The investment is made with a Money Market Fund which, at the time the investment is made, has been awarded the highest credit rating, (AAA), by a credit rating agency.
- The investment is made with the PCC's own bank.
- The investment is made with a Nationalised Bank or Building Society
- The investment is made with a Bank or Building Society that is part owned by the UK Government

Where officers become aware of a revision of a body's rating the body should be removed from the list of Specified Investments.

All Specified Investments must be denominated in sterling and must be one where the PCC may require it to be repaid or redeemed within 12 months of the date on which the investment is made. The investment must not constitute the acquisition of share capital or loan capital in any body corporate.

- The maximum investment with any counterparty is £10 million.
- The maximum investment in any one group (i.e. a bank and its wholly-owned subsidiaries) is £15 million.

Limits and Definition of Non-Specified Investments

These are any other type of investment (i.e. not defined as specified above).

All Non-Specified Investments must be denominated in sterling. The PCC has determined that it will only use approved counterparties within the UK. The investment must not constitute the acquisition of share capital or loan capital in any body corporate.

- The maximum investment with any counterparty is £7 million.
- The maximum investment in any one group (i.e. a bank and its wholly-owned subsidiaries) is £10 million.

This PCC applies the creditworthiness service provided by Capita Asset Services (Sector). This service employs a sophisticated modelling approach utilising credit ratings from the three main credit rating agencies - Fitch, Moody’s and Standard and Poor’s. The credit ratings of counterparties are supplemented with the following overlays:

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

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

Sector Colour Code	Current Investment period
Green	3 months
Red	6 months
Orange	12 months
Blue	12 months
Purple	12 months
Yellow	12 months

The Treasury Management Function takes cognisance of latest market information produced by the treasury advisors (Sector) to support decisions regarding maturity periods and counterparty limits