AVON & SOMERSET
POLICE & CRIME COMMISSIONER

PCC DECISION	REF 2020/003

Decision Title: Treasury Management Strategy 2020/21

Decision summary:
Decision to:-

1. Approve the Treasury Borrowing Strategy (Section 2) for the financial year 2020-21.
2. Approve the Treasury Investment Strategy (Section 3) for the financial year 2020-21.
3. Note the Prudential Indicators (Section 4) for the financial years 2020-2023.

Background or reference to supporting papers:

Treasury Management Strategy 2020-21.

Avon and Somerset Police & Crime Commissioner
I confirm I have considered whether or not I have any declarations of disclosable interest in this matter. Any such interests are disclosed.

The above request has my approval.

Date 21/9/20

Police & Crime Commissioner for Avon & Somerset

CFO Signatures **Date**
(OCC CFO required if decision requested or presented for approval by Constabulary)

PCC CFO ***OCC CFO***

Other relevant lead officer as required **Date**
(e.g PCC CEO, COG lead)

PCC CEO	M Simmonds	
Job title	***name***	***signature***

Item 6

POLICE AND CRIME COMMISSIONER FOR AVON AND SOMERSET (PCC)

POLICE & CRIME BOARD MAY 2020

TREASURY MANAGEMENT STRATEGY 2020-21

REPORT OF THE PCC's CHIEF FINANCE OFFICER

1. Introduction and Background

This report brings together the requirements of the Chartered Institute of Public Finance Accountants (CIPFA) Treasury Management in the Public Services Code of Practice Revised 2017 Edition (CIPFA TM Code), and the CIPFA Prudential Code for Capital Finance in Local Authorities: Revised 2017 Edition (CIPFA Prudential Code). Whilst most of the requirements of the 2018 Ministry of Housing, Communities and Local Government (MHCLG) Investment Guidance are no longer relevant to Treasury Management Investments (it now overwhelmingly refers to non-treasury investments), this report does adhere to MHCLG guidance to prioritise Security, Liquidity and Yield, in that order.

Non-treasury investments are substantially covered by the 2018 Revised MCHLG guidance and would be presented to the PCC in a separate Investment Strategy if they were to be considered (they are not at this point in time).

The PCC acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving best value in treasury management, and to employing suitable performance measurement techniques, within the context of effective risk management.

Treasury management is the management of the PCC's cash flows, borrowing and treasury investments, and the associated risks. The PCC has significant debt and treasury investment portfolios and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of financial risk are therefore central to the PCC's prudent financial management.

Treasury risk management at the PCC is conducted within the framework of the CIPFA Treasury Management in the Public Services: Code of Practice 2017 Edition (the CIPFA Code) which requires the PCC to approve a treasury management strategy before the start of each financial year. This report fulfils the PCC's legal obligation under the Local Government Act 2003 to have regard to the CIPFA Code.

Under Section 3 of the LGA 2003 (duty to determine affordable borrowing limit), a Local Authority must have regard to the CIPFA Prudential Code. This code requires the setting of a number of Prudential Indicators, benchmarks within which Treasury and Investment Management, and Capital Financing are managed. The setting of Prudential Indicators for Treasury Management requires Authorities to recognise key implications of their borrowing and investment strategies. These relate to the affordability of overall borrowing limits, the maturity structure of borrowing, and longer-term investments.

In formulating the Treasury Management Strategy, and the setting of Prudential Indicators, the PCC adopts the Treasury Management Framework and Policy recommended by CIPFA. These can be found in Appendix A.

The current TMPs are attached for information as Appendix C to this report and set out the main categories of risk that may impact on the achievement of Treasury Management objectives. No treasury management activity is without risk. The successful identification, monitoring and control of risks are the prime criteria by which the effectiveness of its treasury management activities will be measured. The main risks to the PCC's treasury activities are:

- Credit and Counterparty Risk (security of investments)
- Liquidity Risk (inadequate cash resources)
- Market or Interest Rate Risk (fluctuations in price / interest rate levels)
- Refinancing Risk (impact of debt maturing in future years)
- Legal & Regulatory Risk

The schedules to the TMPs provide details of how those risks are actively managed.

External Context

The UK's progress negotiating its future trading arrangements with the European Union (EU) will continue to be a major influence on the PCC's treasury management strategy for 2020-21.

UK Consumer Price Inflation (CPI) for November registered 1.5% year on year, unchanged from the previous month. Recent labour market data for the three months to October 2019 showed the unemployment rate at 3.8% while the employment rate was 76.2%. The headline 3-month average annual growth rate for pay slowed to 3.5% in October.

GDP growth rose by 0.3% in the third quarter of 2019 from -0.2% in the previous three months with the annual rate falling further below its trend rate to 1.0% from 1.2%. Looking ahead, the Bank of England's Monetary Policy Report forecasts economic growth to pick up during 2020 as Brexit-related uncertainties dissipate and provide a boost to business investment helping GDP reach 1.6% in Q4 2020, 1.8% in Q4 2021 and 2.1% in Q4 2022.

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

Growth in Europe remains soft, driven by a weakening German economy which saw GDP fall -0.1% in Q2 and is expected to slip into a technical recession in Q3. Euro zone inflation was 0.8% year on year in September, leading to the central bank holding its main interest rate at 0% while cutting the deposit facility rate to -0.5%.

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

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

Looking forward, the potential for problems negotiating a trade-deal with the EU, and a global recession remain the major risks facing banks and building societies in 2020-21 and a cautious approach to bank deposits remains advisable. Although many financial commentators have maintained their Bank Rate forecast at 0.75% for the foreseeable future, there are substantial risks to this forecast, dependant on EU trade deal negotiation outcomes and the evolution of the global economy. Risk are weighted to the downside.

Gilt yields have risen but remain low due to the soft UK and global economic outlooks. US monetary policy and UK government spending will be key influences alongside UK monetary policy. Gilt yields are expected to remain at relatively low levels for the foreseeable future and the risks to this are judged to be broadly balanced. 10-year and 20-year gilt yields are forecast to move up slowly over a 4-year period, from 0.75% to 1.00%, and 1.20% to 1.40% respectively: However, volatility arising from both economic and political events are likely to continue to offer borrowing opportunities.

<u>Internal Context</u>

As at 31st December 2019 the external long-term debt portfolio of the PCC stood at just over £40m as in the table below.

	Balance on 31-03-2019 £m	**Debt Matured / Repaid £m**	**New Borrowing £m**	**Balance on 31-12-2019 £m**	**Borrowing Increase/ Decrease £m**
Short Term Borrowing	0.00	0.00	0.00	0.00	0.00
PWLB	29.35	-0.95	0.00	28.40	-0.95
LOBOs	5.28	0.00	0.00	5.28	0.00
Fixed Rate Loans	6.50	0.00	0.00	6.50	0.00
Total Borrowing	**41.13**	**-0.95**	**0.00**	**40.18**	**-0.95**

The investment portfolio at the same time stood at just under £58.7m.

	Balance at 31-03-2019 £m	Rate of Return at 31-3-2019 %	Balance at 31-12-2019 £m	Rate of Return at 31-12-2019 %
Liquid Balances (Variable)	9.81	0.79	15.67	0.73
Fixed Deposits	32.00	0.97	40.00	0.98
CCLA Property Fund	3.00	4.27	3.00	4.35
Total Lending	**44.81**	**1.15**	**58.67**	**1.09**

The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while useable reserves and working capital are the underlying resources available for investment.

Statutory guidance is that debt should remain below the CFR, except in the short-term. The PCC expects to comply with this in the medium term.

In the table below, as shown in the Capital Strategy, the 'Assumed debt not yet taken' row indicates that £11.35m of new borrowing could be needed by the end of March 2021. Timings of actual capital expenditure linked to the capital plan are not totally predictable, but it is envisaged that the £5m of borrowing will be necessary during 2020-21. This will be in addition to £6.25m that is required for 2019-20, and which is expected to be borrowed before the end of March 2020.

External Debt and the Capital Financing Requirement in £ millions.

	31.3.2019 actual £m	31.3.2020 forecast £m	31.3.2021 budget £m	31.3.2022 budget £m	31.3.2023 budget £m
Short term debt	0.0	0.0	0.0	0.0	0.0
Long term debt *	41.1	46.1	49.7	48.7	47.4
Assumed debt not yet taken (included in above)	*0.00*	*6.3*	*11.4*	*12.4*	*12.4*
PFI Liability	56.5	55.0	53.3	51.6	49.7
Total external borrowing	**97.6**	**101.1**	**103.0**	**100.3**	**97.1**
Capital Financing Requirement	**100.0**	**102.9**	**104.5**	**101.5**	**97.1**

*Reduces for Minimum Revenue Provision (MRP) & debt repayment

The PCC has a projected cash income of approximately £328.5m for 2020-21.

These factors represent significant cash flow, and debt and investment portfolio management for the PCC. In the current financial and economic environment and taking into account potential influencing factors, it is imperative that the PCC has strategies and policies in place to manage flows and balances effectively. The strategies and policies herein state the objectives of Treasury Management for the year and set out the framework to mitigate the risks to successfully achieve those objectives.

2. Borrowing Strategy

The PCC currently holds £40.18m of loans, (and an anticipated £6.26m more to be taken before 31st March 2020) as part of its strategy for funding previous years' capital programmes. The balance sheet forecast in the table above shows that the PCC may have a need to borrow up to £5.1m in 2020-21, and a further £1m in 2021-22. The PCC may also borrow additional sums to pre-fund future years' requirements, providing this does not exceed the authorised limit for borrowing.

Objectives: The PCC's chief objective when borrowing money is to strike an appropriately low risk balance between securing low interest costs and achieving certainty of those costs over the period for which funds are required. The flexibility to renegotiate loans should the PCC's long-term plans change is a secondary objective.

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

By doing so, the PCC is able to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk. The benefits of internal or short-term borrowing will be monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing rates are forecast to rise modestly. Somerset County Council (SCC) officers will monitor the 'cost of carry' and in conjunction with the PCC Chief Finance Officer (CFO), will determine whether the PCC borrows additional sums at long-term fixed rates in 2020-21 with a view to keeping future interest costs low, even if this causes additional cost in the short-term.

The PCC has previously raised most of its long-term borrowing from the PWLB or via LOBOs with banks. Current policy is not to take further LOBO loans, and the government increased PWLB rates by 1% in October 2019. As a result of the rise in PWLB rates, commercial lenders are now actively seeking to lend to Local Authorities. The PCC will look to borrow long-term loans from sources in addition to the PWLB, including banks, pensions and local authorities, in order to lower interest costs and reduce over-reliance on one source of funding in line with the CIPFA Code.

The PCC may also arrange forward starting loans, where the interest rate is fixed in advance, but the cash is received in later years. This would enable certainty of cost to be achieved without suffering a cost of carry in the intervening period.

The use of Call Accounts and MMFs will continue for short-term liquidity; However, it may be appropriate and/or necessary to borrow short-term to cover cash flow fluctuations. Where this is deemed advantageous, short-term funds will be obtained from the money market using the services of a panel of money market brokers.

Sources of borrowing: Approved sources of borrowing are cited in the TMPs. Since PWLB rates were raised by 1% in October 2019, more commercial lenders are entering the market and are actively looking to lend to Local Authorities. Whilst previously the primary source for borrowing would have been the Public Works Loan Board (PWLB), newly available options will be sought and considered. It is envisaged that any new borrowing will be in the short to medium-term periods (up to 25 years), as this is most compatible with the current maturity profile. Interest rates for these maturities are expected to remain lowest as the continued economic uncertainty necessitates lower interest rates for longer. A smaller amount of longer-dated borrowing may also be deemed appropriate when considering the overall portfolio.

Whilst all options will be explored, the flexibility of type, size, and timing of PWLB loans means that they will probably remain the primary source for new borrowing. Variable rate loans currently mitigate the cost of carry. Shorter-dated Equal Instalment of Principal (EIP) loans are cheaper than loans paid on maturity and are repaid systematically in equal instalments over their life. Both will be actively considered, as will shorter dated loans (1-3 years) from other Local Authorities.

No new borrowing will be in the form of LOBOs. The PCC will continue with the current policy not to accept any option to pay a higher rate of interest on its' LOBO loans and will exercise its own option to repay the loan should a lender exercise an option. The PCC will also investigate opportunities to repay where a lender is looking to exit the LOBO by selling the loan. This would be done in conjunction with SCC and their advisors Arlingclose. The PCC may utilise cash resources for repayment or may consider replacing any loan(s) by borrowing from the PWLB or other Local Authorities.

Debt rescheduling: The PWLB allows authorities to repay loans before maturity and either pay a premium or receive a discount according to a set formula based on current interest rates. Other lenders may also be prepared to negotiate premature redemption terms. The PCC may take advantage of this and replace some loans with new loans, or repay loans without replacement, where this is expected to lead to an overall cost saving or a reduction in risk. SCC officers continually monitor repayment rates and calculate premiums to identify opportunities to repay or reschedule PWLB loans.

3. Investment Strategy

In 2018, the MHCLG issued revised Statutory Guidance on Local Government Investments (3rd Edition). It states "Investments made by local authorities can be classified into one of two main categories:

- Investments held for treasury management purposes; and
- Other investments.

"Where local authorities hold treasury management investments, they should apply the principles set out in the Treasury Management Code. They should disclose that the contribution that these investments make to the objectives of the local authority is to support effective treasury management activities. The only other element of this Guidance that applies to treasury management investments is the requirement to prioritise Security, Liquidity and Yield in that order of importance".

The changes made to the 3rd edition of this Guidance reflect changes in patterns of local authority behaviour. Some local authorities are investing in non-financial assets, with the primary aim of generating profit. Others are entering into very long-term investments or providing loans to local enterprises or third sector entities as part of regeneration or economic growth projects that are in line with their wider role for regeneration and place making.

In addition, the National Audit Office and the Public Accounts Committee have raised a number of concerns about local authority behaviour that this guidance aims to address. These are:

- Local authorities are exposing themselves to too much financial risk through borrowing and investment decisions;
- There is not enough transparency to understand the exposure that local authorities have as a result of borrowing and investment decisions; and
- Members do not always have sufficient expertise to understand the complex transactions that they have ultimate responsibility for approving.

This strategy applies only to investments held for treasury purposes. Any non-treasury investments are dealt with in a separate Investment Strategy. The PCC's treasury investments can be divided into three main areas.

- Monthly working capital (Approximately £25m) - This is regular monthly grant and precept income received and used to pay monthly outgoings such as creditors and payroll. This is invested very short term to help smooth cash flows.
- Funds which have been identified as not being immediately required (Approximately £25m) – This pot is core balances / reserves, and can be invested for longer periods, providing sufficient liquidity is maintained via a rolling portfolio of loans.
- Annual Pensions top-up (£60.3m for 2019-20). This rump of cash is generally spent evenly throughout the year, and can be invested accordingly, i.e. investments with maturities spread evenly throughout the year.

Total balances for 2019-20 to the end of December have ranged between £22.4m to £105.0m, averaging £70.6m. The strategy must address risks presented by the large spread between the minimum and maximum balances.

Objectives: The CIPFA Code requires the PCC to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The PCC's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income. With this in mind, the PCC has set an objective of achieving a gross return of 0.5% above 7-day LIBID, over a rolling 3-year period.

Strategy: Short-term, mainly revenue cash will be lent for short periods where appropriate, with authorised counterparties, either by direct contact or via brokers. Call Accounts and Money Market Funds (MMFs) will also be used to provide instant liquidity. AAA rated MMFs offer a high security, high liquidity investment into an extremely diversified portfolio.

The pool of funds identified as not immediately needed, i.e. earmarked reserves and core balances (circa £25m) will be invested for longer periods when investment conditions are deemed favourable, to protect against a prolonged period of low interest rates. The pensions top-up will be invested via both short-term call facilities and the use of time deposits up to 1 year.

The list of further potential investment activities below was included last year, and they will continue to be monitored and assessed as alternatives to mitigate bail-in risk and falling, potentially negative returns.

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

Implementation: The CFO, under delegated powers, will undertake the most appropriate form of investments in keeping with the investment objectives, income and risk management requirements and Prudential Indicators. He in turn commissions treasury management services including implementing policy to Treasury Management Officers at SCC. This is done by using only the agreed investment instruments, and credit criteria below and in appendix B. As is current procedure, the use of a new instrument or counterparty would need to be specifically authorised by the CFO. Details of deposits and investments taken by SCC Officers are reported monthly to the Chief Finance Officer and discussed at quarterly meetings.

Approved Investments: The list below shows currently approved instruments, with a brief description of current and potential investment instrument characteristics underneath.

- Business Reserve Accounts and term deposits.
- Deposits with other Local Authorities.
- Low Volatility Net Asset Value (LVNAV) Money Market Funds
- The Debt Management Office (DMO)
- Variable Net Asset Value (VNAV) Money Market Funds.
- Gilts and Treasury Bills.
- Certificates of Deposit with Banks and Building Societies
- Commercial Paper
- Use of any public or private sector organisation that meets the creditworthiness criteria rather than just banks and building societies.
- Building Societies – Including unrated Societies with better creditworthiness than their credit rated peers.
- Corporate Bonds – Can offer access to high credit rated counterparties, such as utility, supermarket, and infrastructure companies.
- Covered Bonds and Reverse Repurchase Agreements (Repos) present an opportunity to invest short-term with banks on a secured basis and hence be exempt from bail-in.

- Pooled Funds. These funds allow the PCC to diversify into asset classes other than those above, without the need to own and manage the underlying investments. Bond, equity and property funds offer enhanced returns over the longer term but are more volatile in the short term. Their values change with market prices, so will be considered for longer investment periods. It would be the PCC's intention to be to be invested in longer-dated Bond Funds, Equity Funds, or Property Funds for at least 3-5 years.

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

Banks secured: Covered bonds, reverse repurchase agreements and other collateralised arrangements with banks and building societies. These investments are secured on the bank's assets, which limits the potential losses in the unlikely event of insolvency, and means that they are exempt from bail-in.

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

Corporates: Loans, bonds and commercial paper issued by companies other than banks and registered providers. These investments are not subject to bail-in but are exposed to the risk of the company going insolvent.

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

Pooled funds: Shares or units in diversified investment vehicles. These funds have the advantage of providing wide diversification of investment risks, coupled with the with the services of a professional fund manager in return for a fee. Short-term Money Market Funds that offer same-day liquidity and very low or no volatility will be used as an alternative to instant access bank accounts, while pooled funds whose value changes with market prices and/or have a notice period may be used for longer investment periods.

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

Approved counterparties – Credit Rated: The PCC maintains a restricted list of financial institutions to be used as counterparties, and in accordance with the credit criteria set out in appendix B. Any proposed additions to the list must be approved by the CFO.

Approved counterparties – Non-Credit Rated: As investment decisions are never made solely based on credit ratings, and some institutions may not have ratings at all, account will be taken of any relevant credit criteria in appendix B, and any other relevant factors; Again, potential counterparties will be specifically authorised by the CFO.

Credit rating: The PCC has constructed and will maintain a counterparty list based on the criteria set out in Appendix B. The minimum credit quality is proposed to be set at A- or equivalent. The credit standing of institutions (and issues if used) will be monitored and updated on a regular basis.

SCC will continuously monitor counterparties creditworthiness. All three credit rating agencies' websites will be visited frequently, and all ratings of proposed counterparties will be subject to verification on the day of investment. (MHCLG guidance states that a credit rating agency is one of Standard & Poor's, Moody's Investor Services Ltd, and Fitch Ratings Ltd). All ratings of currently used counterparties will be reported in the monthly treasury management papers, where proposals for any new counterparties may be put forward. New counterparties must be approved by the CFO before they are used. Any changes to ratings that put the counterparty below the minimum acceptable credit quality whilst we have a deposit, or a marketable instrument will be brought to the attention of the CFO immediately, and an appropriate response decided on a case-by-case basis. Sovereign credit ratings will be monitored and acted on as for financial institution ratings. Investment limits are set by reference to the lowest published long-term credit rating from the three rating agencies mentioned above. Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used.

Other information on the security of investments: The PCC understands that credit ratings are good, but not perfect predictors of investment default. Full regard will therefore be given to other available information on the credit quality of the organisations in which it invests, including those outlined below.

- Credit Default Swaps and Government Bond Spreads.
- GDP and Net Debt as a Percentage of GDP for sovereign countries.
- Likelihood and strength of Parental Support.
- Banking resolution mechanisms for the restructure of failing financial institutions, i.e. bail-in.
- Market information on corporate developments and market sentiment towards the counterparties and sovereigns.
- Underlying securities or collateral for 'covered instruments'.
- Other macroeconomic factors

It remains the PCC's policy to suspend or remove institutions that still meet criteria, but where any of the factors above give rise to concern. Also, when it is deemed prudent, the duration of deposits placed is shortened or lengthened, depending on counterparty specific metrics, or general investment factors.

The extent of these restrictions will be in line with prevailing financial market conditions. If these restrictions mean that insufficient commercial organisations of high credit quality are available to invest the PCC's cash balances, then the surplus will be deposited with the UK Government via the Debt Management Office or invested in government treasury bills for example, or with other local authorities. This will cause a reduction in the level of investment income earned but will protect the principal sum invested.

Investment limits: Investment limits are set out in appendix B.

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

4. Prudential and Treasury Management Indicators

The PCC measures and manages its exposures to treasury management risks using the following indicators.

Authorised limit and Operational Boundary: The PCC is required to set an authorised limit and an operational boundary for external debt.

	2020-21 £m	**2021-22 £m**	**2022-23 £m**
Authorised limit			
- Borrowing	52	51	50
- Other long-term liabilities	55	54	52
Total	**107**	**105**	**101**
Operational boundary			
- Borrowing	50	49	48
- Other long-term liabilities	53	52	50
Total	**103**	**101**	**97**

CIPFA no longer recommends setting upper limits on fixed and variable rate exposures, so these are no longer calculated for this paper.

Maturity Structure of Borrowing: The PCC has set for the forthcoming year, both the upper and lower limits with respect to the maturity structure of its borrowing. The calculation is the amount of projected borrowing maturing in each period, expressed as a percentage of the total projected borrowing. CIPFA Code guidance for the 'maturity structure' indicator states that the maturity of LOBO loans should be treated as if their next option date is the maturity date. The 'maturity structure of borrowing' indicators have been set with regard to this, and having given due consideration to proposed new borrowing, current interest rate expectations, and the possibility of rescheduling or prematurely repaying loans outlined in the borrowing strategy. The periods to be used going forward and the limits are the same as for 2019-20.

	Upper Limit	Lower Limit
Under 12 months	30%	0%
> 12 months and < 24 months	30%	0%
> 24 months and < 5 years	25%	5%
> 5 years and < 10 years	25%	0%

> 10 years and < 20 years	35%	0%
> 20 years and < 30 years	15%	0%
> 30 years and < 40 years	45%	10%
> 40 years and < 50 years	10%	0%
> 50 years	0%	0%

Principal sums invested for periods longer than a year: The purpose of this indicator is to control the PCC's exposure to the risk of incurring losses by seeking early repayment of its investments.

It is possible that the PCC may place a small number of deposits for more than one year. Should the PCC wish to diversify more into pooled funds, it would be the PCC's intention to be invested in these for periods of 3-5 years plus. Therefore, a prudential indicator of £20m is deemed necessary for year 1, with similar amounts for years 2 and 3.

	2020-21 £m	**2021-22 £m**	**2022-23 £m**
Prudential limit for principal sums invested for periods longer than 1 year	20	20	20

Credit Risk Indicator: The PCC has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating / credit score of its in-house (SCC) managed investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment. Unrated investments are assigned a score based on their perceived risk and will be calculated quarterly.

Credit risk indicator	**Target**
Portfolio average credit rating (score)	A (6.0)

5. Other Matters

The CIPFA Code requires the PCC to include the following in its treasury management strategy.

Derivative Instruments: The code requires that the PCC must explicitly state whether it plans to use derivative instruments to manage risks. The general power of competence in Section 1 of the *Localism Act 2011* removes much of the uncertainty over local authorities' use of standalone financial derivatives (i.e. those that are not embedded into a loan or investment). However, the authority does not intend to use derivatives.

Should this position change, the PCC may seek to develop a detailed and robust risk management framework governing the use of derivatives, but this change in strategy will require PCC approval.

External Service Providers: The code states that external service providers should be reviewed regularly and that services provided are clearly documented, and that the quality of that service is controlled and understood.

Officers from the SCC Treasury Management team report debt and investment positions and performance via monthly papers, and at quarterly meetings with the PCC Chief Finance Officer. As required by the CIPFA TM Code, the Chief Finance Officer reports to the PCC via the Police and Crime Board on its treasury activities in the form of a mid-year review and an Annual Treasury Management Report.

Member Training: All public service organisations should be aware of the growing complexity of treasury management in general, and its application to the public services in particular. Modern treasury management, and particularly non-treasury investments (should they be entered into) demand appropriate skills.

The new Investment Strategy demands a greater level of understanding and involvement by members, and that document sets out the specific requirements for that purpose; However, there should still be an appropriate level of skills and understanding applied to the Treasury Management Strategy.

SCC Officers would be able and willing to provide a level of training, if the PCC CFO thought that there would be no conflict of interest. SCC could also facilitate training via an independent third party and have contacts within a number of money market brokers and fund managers who could provide training. As and when needed, briefing sheets could be prepared and distributed to keep the PCC and the PCC CFO/CEO abreast of current developments.

Markets in Financial Instruments Directive II (MiFID II): As a result of the second Markets in Financial Instruments Directive (MiFID II), from 3rd January 2018 local authorities were automatically treated as retail clients but could "opt up" to professional client status, providing certain criteria was met. This included having an investment balance of at least £10 million and the person(s) authorised to make investment decisions on behalf of the authority have at least a year's relevant professional experience. In addition, the regulated financial services firms to whom this directive applies have had to assess that that person(s) have the expertise, experience and knowledge to make investment decisions and understand the risks involved. Each regulated Financial Services firm undertakes a separate assessment with ongoing compliance.

The PCC continues to meet the conditions to opt up to professional status and has done so in order to maintain its erstwhile MiFID II status prior to January 2018. As a result, the PCC will continue to have access to products including money market funds, pooled funds, treasury bills, bonds, shares and to financial advice.

6. Recommendations

The PCC is recommended to:-

1. Approve the Treasury Borrowing Strategy (Section 2) for the financial year 2020-21.
2. Approve the Treasury Investment Strategy (Section 3) for the financial year 2020-21.
3. Note the Prudential Indicators (Section 4) for the financial years 2020-2023.

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Background papers

Local Government Act 2003 – Guidance under section 15(1)(a) 3rd Edition, effective from 1 April 2018.

The CIPFA 'Treasury Management in the Public Services' Code of Practice Revised Edition 2017.

CIPFA Prudential Code for Capital Finance in Local Authorities: Revised Edition 2017.

Appendix A

Treasury Management Policy Statement

Introduction and Background

1.1 The (Office of) the Police and Crime Commissioner (PCC) adopts the key recommendations of CIPFA's Treasury Management in the Public Services: Code of Practice (the code), as described in Section 5 of the Code

1.2 Accordingly, the PCC will create and maintain, as the cornerstones for effective treasury management: -

- A treasury management policy statement, stating the policies, objectives and approach to risk management of its treasury management activities.
- Suitable treasury management practices (TMPs), setting out the manner in which the organisation will seek to achieve those policies and objectives, and prescribing how it will manage and control those activities.

1.3 The PCC and Finance Committee will receive reports on its treasury management policies, practices and activities, including, as a minimum, an annual strategy and plan in advance of the year, a mid-year review, and an annual report after its close, in the form prescribed in its TMPs.

1.4 The PCC delegates responsibility for the implementation and regular monitoring of its treasury management policies and practices, and for the execution and administration of treasury management decisions to the Chief Finance Officer as Section 151 Officer, who will act in accordance with the organisation's policy statement and TMPs and, if he/she is a CIPFA member, CIPFA's Standard of Professional Practice on Treasury Management.

1.5 The PCC nominates the Audit Committee to be responsible for ensuring effective scrutiny of the treasury management strategy and policies.

Policies and Objectives of Treasury Management Activities

2.1 The PCC defines its treasury management activities as: -

> *"The management of the organisation's investments and cash flows, its 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."*

2.2 This PCC regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the organisation, and any financial instruments entered into to manage these risks.

2.3 This PCC acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving value for money in treasury management, and to employing suitable performance measurement techniques, within the context of effective risk management.

2.4 The PCC's borrowing will be affordable, sustainable and prudent and consideration will be given to the management of interest rate risk and refinancing risk. The source from which the borrowing is taken, and the type of borrowing should allow the PCC transparency and control over its debt.

2.5 The PCC's primary objective in relation to investments remains the security of capital. The liquidity or accessibility of the PCC's investments followed by the yield earned on investments remain important, but are secondary considerations.

<u>PCC Lending Counterparty Criteria 2020-21</u> Appendix B

The following criteria will be used to manage counterparty risks to the Police and Crime Commissioner for Avon and Somerset Investments for new deposits / investments from the time that the new Treasury Management Strategy is passed by Police & Crime Board at its meeting in April 2020: -

Where deposits held were made under previous criteria, there will be no compulsion to terminate those deposits to meet new criteria, where a penalty would be incurred.

Deposits - Any Financial Institution that is authorised by the Prudential Regulation Authority to accept deposits, or is a passported EEA institution, which is entitled to accept deposits in the UK, or is a UK Building Society can be lent to, subject to the rating criteria below at the time of the deposit.

Unrated Building Societies
Unrated Building Societies as identified by SCC can be used, with a maximum of £1m per Society and a maximum maturity of 1 year.

Marketable Instruments – Any bank, other organisation, or security whose credit ratings satisfy the criteria below: -

Rating of Counterparty or Security
<u>Deposits or instruments of less than 13 months duration (Refer to long-term ratings)</u>
Fitch A- or above
S&P A- or above
Moody's A3 or above

The maximum deposit / investment amount for any authorised counterparty or security that has as a minimum at least two ratings of the three above will be £7m (approximately 6.7% of maximum balances and 9.9% of average investments during 2019-20, to December 31st).

The maximum deposit / investment amount for any authorised counterparty or security that has as a minimum - Fitch AA-, S&P AA-, and Moody's Aa3, will be £8m (approximately 7.6% of maximum balances and 11.3% of average investments during 2019-20, to December 31st)

<u>Deposits or instruments of more than 13 months duration (Refer to long-term ratings)</u>
Fitch AA- or above
S&P AA- or above
Moody's Aa3 or above

The maximum deposit / investment amount for more than 13 months for any authorised counterparty or security that has as a minimum at least two ratings of the three above will be £3m. This figure is to be included in the overall figure above.

The allowed deposit amounts above are the single maximum per counterparty at any one time, and that counterparty or security must be rated as above or better by at least two of the three agencies. Short-term ratings will be monitored and considered in relative rather than absolute terms.

It remains the PCC's policy to suspend or remove institutions that still meet criteria, but where any of the other factors below give rise to concern. Also, when it is deemed prudent, the duration of deposits placed is shortened or lengthened, depending on counterparty specific metrics, or general investment factors.

Operational Bank Accounts
The PCC's current bankers Nat West are currently within the minimum criteria. If they should fall below criteria, the instant access Call Account facility may still be used for short-term liquidity requirements and business continuity arrangements. This will generally be for smaller balances where it is not viable to send to other counterparties or in the event of unexpected receipts after the daily investment process is complete. Money will be placed in the instant access Nat West call account overnight.

Public Sector Bodies
Any UK Local Authority or Public Body will have a limit of £5m and a maximum maturity of 5 years.

The UK Government, including Gilts, T-Bills, and the Debt Management Office (DMADF) will be unlimited in amount and duration.

The table below gives a definition and approximate comparison of various ratings by the three main agencies: -

Definitions of Rating Agency Ratings

	Fitch		Moody's		S&P	
Short-Term	F1+	Exceptionally strong	P-1	Superior	A-1+	Extremely strong
	F1	Highest quality			A-1	Strong
	F2	Good quality	P-2	Strong	A-2	Satisfactory
	F3	Fair quality	P-3	Acceptable	A-3	Adequate
	B	Speculative	NP	Questionable	B and below	Significant speculative characteristics
	C	High default risk				
	(+) or (-)		(1,2, or 3)		(+) or (-)	
Long-Term	AAA	Highest quality	Aaa	Exceptional	AAA	Extremely strong
	AA	V High quality	Aa	Excellent	AA	Very strong
	A	High quality	A	Good	A	Strong
	BBB	Good quality	Baa	Adequate	BBB	Adequate capacity
	BB	Speculative	Ba	Questionable	BB and below	Significant speculative characteristics
	B	Highly Speculative	B	Poor		
	CCC	High default risk	Caa	Extremely poor		

Financial Groups
For Financial Groups (where two or more separate counterparties are owned by the same eventual parent company) investments can be split between entities, but an overall limit equal to the highest rated constituent counterparty within the group will be used.

Country Limits
Excluding the UK, there will be a limit of £10m of investments in any one country. (approximately 9.5% of maximum balances and 14.2% of average investments during 2019-20, to December 31st).

Money Market Funds
With regulatory changes now effected, previously titled Constant Net Asset Value (CNAV) Money Market Funds have been converted into Low Volatility Net Asset Value (LVNAV) funds. Any LVNAV Fund used must be rated by at least two of the main three ratings agency, and must have the following, (or equivalent LVNAV) ratings.

Fitch AAAmmf	Moody's Aaa-mf	Standard & Poor's AAAm

Subject to the above, deposits can be made with the following limits: -
The lower of £8m or 0.5% of the total value for individual Funds.
No more than 50% of total deposits outstanding are to be held in LVNAV MMFs.

VNAV Pooled Funds
Currently, not all Variable Net Asset Value (VNAV) Funds carry a rating. Many VNAV bond funds are not rated. Equity, multi-asset and property funds are also not credit rated. The decision to invest in a particular asset class or fund will be based on the evaluation of the risk/reward characteristics including volatility, expected income return and potential for capital growth.

No more than £10m of total deposits outstanding are to be held in VNAV Funds (excluding LVNAV MMFs).

Other Indicators
The PCC will continue to use a range of indicators, not just credit ratings. Among other indicators to be taken into account will be: -

- Credit Default Swaps and Government Bond Spreads.
- GDP, and Net Debt as a Percentage of GDP for sovereign countries.
- Likelihood and strength of Parental Support.
- Banking resolution mechanisms for the restructure of failing financial institutions, i.e. bail-in.
- Share Price.
- Market information on corporate developments and market sentiment towards the counterparties and sovereigns.
- Underlying securities or collateral for covered instruments.
- Other macroeconomic factors