Item 7b

POLICE AND CRIME COMMISSIONER FOR AVON AND SOMERSET (PCC)

POLICE & CRIME BOARD 2 MARCH 2022

TREASURY MANAGEMENT STRATEGY 2022-23

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 and Accountancy (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.

New CIPFA Treasury Management and Prudential Codes were published in December 2021, too late to be wholly incorporated into this year's written strategy.

However, PCC Treasury Management will operate within the letter and the spirit of the revised Codes.

The foreword of the Prudential Code states that the new code takes immediate effect, except that Authorities may defer introducing the revised reporting requirements until the 2023/24 financial year. It particularly highlights that the requirement that local authorities must not borrow to invest primarily for financial return applies with immediate effect.

Within the new code, the new section, 'Prudence in borrowing and investment' is the key change in the code.". It states "legitimate examples of prudent borrowing " as:

- Financing capital expenditure primarily related to the delivery of a local authority's functions.
- Temporary management of cash flow within the context of a balanced budget.
- Securing affordability by removing exposure to future interest rate rises.
- Refinancing current borrowing, including adjusting levels of internal borrowing, to manage risk, reduce costs or reflect changing cash flow circumstances.
- Other treasury management activity that seeks to prudently manage treasury risks without borrowing primarily to invest for financial return.

The Prudential Code determines that certain acts or practices are not prudent activity for a local authority and incur risk to the affordability of local authority investment; therefore, in order to comply with the Prudential Code, an authority must not borrow to invest primarily for financial return.

It is not prudent for local authorities to make any investment or spending decision that will increase the capital financing requirement, and so may lead to new borrowing, unless directly and primarily related to the functions of the authority; and where any financial returns are either related to the financial viability of the project in question or otherwise incidental to the primary purpose."

Unlike the Prudential Code, there is no mention of the date of initial application in the TM Code, and the guidance notes have yet to be published; However, the PCC will follow the same process as the Prudential Code, i.e. defer introducing the revised reporting requirements until the 2023/24 financial year but following the revised code (when guidance enables and clarifies).

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 ongoing impact on the UK from coronavirus, together with higher inflation, higher interest rates, and the country's trade position post-Brexit, will be major influences on the treasury management strategy for 2022/23.

The Bank of England (BoE) increased Bank Rate to 0.25% in December 2021 while maintaining its Quantitative Easing programme at £895 billion. The Monetary Policy Committee (MPC) voted 8-1 in favour of raising rates, and unanimously to maintain the asset purchase programme.

Within the announcement the MPC noted that the pace of the global recovery was broadly in line with its November Monetary Policy Report. Prior to the emergence of the Omicron coronavirus variant, the Bank also considered the UK economy to be evolving in line with expectations, however with the increased uncertainty and risk to activity the new variant presents, the Bank revised down its estimates for Q4 GDP growth to 0.6% from 1.0%.

Inflation was projected to be higher than previously forecast, with CPI likely to remain above 5% throughout the winter and peak at 6% in April 2022. The labour market was generally performing better than previously forecast and the BoE now expects the unemployment rate to fall to 4% compared to 4.5% forecast previously; but notes that Omicron could weaken the demand for labour.

UK CPI for November 2021 registered 5.1% year on year, up from 4.2% in the previous month. Core inflation, which excludes the more volatile components, rose to 4.0% y/y from 3.4%. The most recent labour market data for the three months to October 2021 showed the unemployment rate fell to 4.2% while the employment rate rose to 75.5%.

In October 2021, the headline 3-month average annual growth rate for wages were 4.9% for total pay and 4.3% for regular pay. In real terms, after adjusting for inflation, total pay growth was up 1.7% while regular pay was up 1.0%. The change in pay growth has been affected by a change in composition of employee jobs, where there has been a fall in the number and proportion of lower paid jobs.

Gross domestic product (GDP) grew by 1.3% in the third calendar quarter of 2021 according to the initial estimate, compared to a gain of 5.5% q/q in the previous quarter, with the annual rate slowing to 6.6% from 23.6%. The Q3 gain was modestly below the consensus forecast of a 1.5% q/q rise. During the quarter activity measures were boosted by sectors that reopened following pandemic restrictions, suggesting that wider spending was flat. Looking ahead, while monthly GDP readings suggest there had been some increase in momentum in the latter part of Q3, Q4 growth is expected to be soft.

GDP growth in the euro zone increased by 2.2% in calendar Q3 2021 following a gain of 2.1% in the second quarter and a decline of -0.3% in the first. Headline inflation has been strong, with CPI registering 4.9% year-on-year in November, the fifth successive month of inflation. Core CPI inflation was 2.6% y/y in November, the fourth month of successive increases from July’s 0.7% y/y. At these levels, inflation is above the European Central Bank’s target of ‘below, but close to 2%’, putting some pressure on its long-term stance of holding its main interest rate of 0%.

The US economy expanded at an annualised rate of 2.1% in Q3 2021, slowing sharply from gains of 6.7% and 6.3% in the previous two quarters. In its December 2021 interest rate announcement, the Federal Reserve continue to maintain the Fed Funds rate at between 0% and 0.25% but outlined its plan to reduce its asset purchase programme earlier than previously stated and signalled they are in favour of tightening interest rates at a faster pace in 2022, with three 0.25% movements now expected.

Internal Context

As at 31st December 2021 the external long-term debt portfolio of the PCC stood at just over £45m as in the table below.

	Balance on 31-03-2021 £m	Debt Matured / Repaid £m	New Borrowing £ms	Balance on 31-12-2021 £m	Increase/ Decrease in Borrowing
Short Term Borrowing	0.00	0.00	0.00	0.00	0.00
PWLB	34.28	-0.94	0.00	33.34	-0.94
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	**46.06**	**-0.94**	**0.00**	**45.12**	**-0.94**

The investment portfolio at the same time stood at just over £73.5m.

	Balance at 31-03-2021 £m	Rate of Return at 31-3-2021 %	Balance at 31-12-2021 £m	Rate of Return at 31-12-2021 %
Liquid Balances (Variable)	10.64	0.02	13.53	0.04
Fixed Deposits	48.00	0.38	57.00	0.24
CCLA Property Fund	3.00	3.84	3.00	3.39
Total Lending	**61.64**	**0.49**	**73.53**	**0.33**

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 £1.1m of new borrowing could be needed by the end of March 2023. Timings of actual capital expenditure linked to the capital plan are not totally predictable, but it is envisaged that the £1.1m of borrowing will be necessary during 2022-23. No borrowing is planned to be required for 2021-22 as previous borrowing will be utilised.

External Debt and the Capital Financing Requirement in £ millions

	31.3.2021 actual	**31.3.2022 forecast**	**31.3.2023 budget**	**31.3.2024 budget**	**31.3.2025 budget**
Short term debt	0	0	0	0	0
Long term debt *	46.01	44.13	44.11	50.61	50.61
Assumed debt not yet taken (inc. in above)	0	0.00	1.10	8.75	16.45
PFI Liability	53.3	51.6	49.7	48.4	46.5
Total external borrowing	**99.31**	**95.73**	**93.81**	**99.01**	**97.11**
Capital Financing Requirement	**100.63**	**98.82**	**98.11**	**103.94**	**109.60**

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

The PCC has a projected cash income of approximately £357m for 2022-23.

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 £45.12m of loans 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 £1.1m in 2022-23, £7.7m in 2023-24 and a further £7.7m in 2024-25. 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: 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 to medium-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 to medium-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 2022-23 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. After the 1% rise in PWLB rates in October 2019, HM Treasury, after a lengthy consultation, reversed the rise, but stated that PWLB loans would no longer be available to local authorities planning to buy investment assets primarily for yield. The PCC intends to avoid this activity in order to retain its access to PWLB loans. The PCC will continue to assess alternatives to borrowing long-term loans from other sources including banks, pensions and local authorities, in order to lower interest costs and reduce over-reliance on one source of funding in line with the CIPFA Code.

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 reduced in December 2020, commercial lenders' offerings are less attractive than previously, but this option will still 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 low as the continued economic uncertainty necessitates low 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.

The new CIPFA codes were designed to deal with investments specifically held primarily for yield (non-Treasury investments). Previously this did not include the use of

Pooled Funds, but it now seems as if they may fall into the non-Treasury investment category. SCC would argue that they are very much used as a Treasury investment by the PCC, matching our reserve requirements and debt liabilities. Whilst the situation at present would appear to be unclear, this strategy, (including currently held Pooled Funds) applies only to investments held for treasury purposes. Any non-treasury investments would be dealt with in a separate Investment Strategy.

Total balances for 2021-22 to the end of December have ranged between £43.8m to £118.8m, averaging £83.2m. 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 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 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.

	2022-23 £m	**2023-24 £m**	**2024-25 £m**
Authorised limit			
Borrowing	52	60	67
Other Long-Term Liabilities	52	51	49
Total	104	111	116
Operational boundary			
Borrowing	50	58	65
Other Long-Term Liabilities	50	49	47
Total	100	107	112

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 2021-22.

	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. Bearing in mind the revised CIPFA Codes, a reduced prudential indicator of £15m is deemed appropriate for year 1, with similar amounts for years 2 and 3.

	2022-23	**2023-24**	**2024-25**
Prudential Limit for principal sums	**£m**	**£m**	**£m**
invested for periods longer than 1 year	15	15	15

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 Finance Committee 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 2022-23.

2. Approve the Treasury Investment Strategy (Section 3) for the financial year 2022-23.

3. Note the Prudential Indicators (Section 4) for the financial years 2022-2025.

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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 2017 Edition, and The CIPFA 'Treasury Management in the Public Services' Code of Practice Revised Edition 2021.

The CIPFA Prudential Code for Capital Finance in Local Authorities: 2017 Edition, and. The CIPFA Prudential Code for Capital Finance in Local Authorities: Revised Edition 2021.