Making Suffolk a safer place to live, work, travel and invest

ORIGINATOR: **CHIEF FINANCE OFFICER**	**PAPER NO:** **AC21/07**

SUBMITTED TO: **AUDIT COMMITTEE – 12 MARCH 2021**

SUBJECT: **MID-YEAR TREASURY MANAGEMENT MONITORING REPORT 2020-21 AND INVESTMENT AND TREASURY MANAGEMENT STRATEGY 2021-22**

SUMMARY:

1. This report presents the mid-year treasury management monitoring report for 2020-21 in line with CIPFA's Code of Practice on Treasury Management and the PCC's 2020-21 Investment and Treasury Management Strategy.

2. This report also presents the updated Investment and Treasury Management Strategy 2021-22, to replace the 2020-21 strategy. The strategy is updated annually to reflect working practices for the PCC and any changes in Regulation, Prudential Code or the Treasury Management Code of Practice. There have been no significant changes since the previous strategy was approved.

RECOMMENDATION:

1. The Audit Committee to note the contents of this report.

DETAIL OF THE SUBMISSION

1. KEY ISSUES FOR CONSIDERATION:

1.1 The mid-year treasury management monitoring report for 2020-21 (see **Appendix 1**) provides information on the treasury management activities of the PCC for the period 1 April 2020 to 30 September 2020. At 30 September 2020, the PCC's external debt excluding PFI was £7.258m, its investments totalled £14.5m and bank balances £0.774m.

1.2 The updated Investment and Treasury Management Strategy 2021-22 (see **Appendix 2**) replaces the 2020-21 strategy. This presents the prudential and treasury indicators and treasury strategy and covers:

- The treasury management strategy, and how investments and borrowings are to be organised, including treasury indicators;
- An investment strategy showing the parameters on how investments are to be managed;
- The capital plans, including prudential indicators (see **Annex A**); and
- A minimum revenue provision policy on how unfunded capital expenditure is charged to revenue over time (see **Annex B**).

2. FINANCIAL IMPLICATIONS:

2.1 There are no financial implications outside of those presented in the strategy and mid-year report.

3. OTHER IMPLICATIONS AND RISKS:

3.1 There are no other implications and risks outside of those presented in this report.

Appendix 1

Mid-year Treasury Management Report 2020-21

1. Introduction

1.1 The Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice for Treasury Management in the Public Sector (the Code), requires that the PCC receives a mid-year review of treasury activities in addition to the forward-looking annual investment and treasury strategy and backward-looking annual treasury report. The Annual Investment and Treasury Strategy for the current year (2020/21) was approved by the PCC on 5 February 2020.

1.2 The PCC operates a balanced budget, which broadly means income receivable during the year will cover expenditure payable and any planned movement on reserves. Part of the treasury management operations ensure this cash flow is adequately planned, with surplus monies being invested in low risk counterparties, providing adequate liquidity initially before considering maximising investment return.

1.3 The second main function of the treasury management service is the financing of the PCC's capital plans. These capital plans provide a guide to the borrowing need of the PCC, essentially the longer-term cash flow planning to ensure the PCC can meet its capital spending operations. This management of longer-term cash may involve arranging long or short-term loans, or using longer term cash flow surpluses, and on occasion any debt previously drawn may be restructured to the PCC's risk or cost objectives.

1.4 As a consequence treasury management is defined as:

"The management of the local authority'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."

1.5 The PCC has delegated responsibility for treasury management decisions taken within the approved strategy to the PCC's Chief Finance Officer. Day to day execution and administration of investment and borrowing decisions are undertaken by the Constabulary.

1.6 The PCC recognises the importance of monitoring treasury management activities, with regular reports being presented to the Audit Committee throughout the year.

1.7 This mid-year review provides commentary on economic conditions produced by Link Asset Services (the PCC's external treasury consultant) and details treasury activities for the period 1 April 2020 to 30 September 2020 including; cash balances and cash flow management, investment performance, counterparty management and long-term borrowing/debt management.

2. Cash Balances and Cash Flow Management

2.1 The PCC's cash and short-term investment balances comprise revenue and capital resources, such as general balances and earmarked reserves and the timing differences between the receipt and payment of monies required to meet the cost of PCC services and the capital programme. The average level of cash and short term-investment balances in the year to date totals £15.071m.

2.2 Cash and short-term investment balances are managed internally and have been invested in accordance with the PCC's approved Authorised Lending List.

2.3 A key objective of cash flow management is to minimise balances held in the PCC's bank accounts in order to ensure that the maximum interest is earned. However presently the interest returned on instant access accounts is similar to those earned on short term lending arrangements. These accounts are therefore frequently utilised within counterparty limits as they provide greater liquidity.

2.4 The PCC operates seven bank accounts. Cash balances across all seven accounts are aggregated and surplus cash balances are invested on a daily basis.

2.5 Year to date (excluding investments and repayments), monies received amounts to £97.7m, while payments total £88.6m, resulting in an overall increase in cash balances of £9.1m.

2.6 By continuing to delay borrowing for capital purposes (Section 6) while at the same time actively managing levels of liquid cash, the PCC on occasions has needed to borrow short-term from the money markets to cover daily liquidity. However there has been no short term borrowing in the review period.

3. Investment Performance

3.1 In accordance with the Code, it is the PCC's priority to ensure security of capital and liquidity, and to obtain an appropriate level of return which is consistent with the PCC's risk appetite. As set out in Section 3, it is a very difficult investment market in terms of earning the level of interest rates commonly seen in previous decades as rates are very low and in line with the current 0.1% Bank Rate. The continuing potential for a re-emergence of a Eurozone sovereign debt crisis together with other risks which could impact on the creditworthiness of banks, prompts a low risk strategy. Given this risk environment, investment returns are likely to remain low.

3.2 At 30 September 2020, the PCC held £14.5m of investments. The profile of these investments is shown below.

Institutional Sector	**Liquid £m**	**Up to 3 months £m**	**Up to 6 months £m**	**Up to 9 months £m**	**Up to 12 months £m**
Part Nationalised Banks	**-**	**-**	**-**	**-**	**-**
UK Banks	**4.5**	**-**	**-**	**-**	**-**
Non-UK Banks	**-**	**-**	**-**	**-**	**-**
Building Societies	**-**	**-**	**-**	**-**	**-**
Other*	**10.0**	**-**	**-**	**-**	**-**
Total	**14.5**	**-**	**-**	**-**	**-**

*Includes: Money Market Funds

3.3 The average interest rate earned for the year to date is 0.1085%.

3.4 Gross interest earned for the period 1st April 2020 to 30th September 2020 is £9.0k.

4. Counterparty Maintenance

4.1 The PCC CFO is responsible for maintaining an Approved Counterparty List in accordance with the criteria as set out in the approved Annual Investment and Treasury Strategy 2020/21. Credit rating information is supplied by our treasury consultants on all active counterparties. Any rating changes, rating watches (notification of a likely change) and rating outlooks (notification of a possible longer-term change) are provided by our treasury consultants immediately they occur. A wide range of market information such as Credit Default Swap prices and share price is also taken into account. The Approved Counterparty List is therefore actively managed on a day-to-day basis and when an institution no longer meets the PCC approved counterparty criteria, it is immediately removed.

4.2 There have been no credit rating downgrades during the period 1st April 2020 to 30th September 2020 that have resulted in counterparties being removed from the authorised counterparty list.

5. Long Term Borrowing/Debt Management

5.1 The PCC undertakes capital expenditure on long-term assets. This activity gives rise to the need to borrow. Part of the PCC's treasury management activity is to address this borrowing need, either through long term borrowing from external bodies (PWLB or commercial banks) or utilising temporary cash resources within the PCC pending long term borrowing.

5.2 In accordance with the approved 2020/21 Investment and Treasury Strategy, the PCC continues to delay new borrowing for capital purposes, using cash balances on a temporary basis to avoid the cost of 'carrying' debt in the short term. Delaying borrowing and running down the level of investment balances also reduces the PCC's exposure to investment counterparty risk.

5.3 At the 30 September 2020, the PCC's external borrowing (debt outstanding, excluding PFI) totalled £7.258m (PWLB)

5.4 The PCC's overall capital financing requirement (excluding PFI) at 31.3.20 was £13.6m. The projected capital financing requirement at 31.3.21 is approximately £13.9m. This represents unfunded capital expenditure for which approved borrowing can be drawn down. The PCC's CFO, under delegated powers, will take the most appropriate form of borrowing depending on the prevailing interest rates at the time, taking into account the risks identified in the economic forecast (Section 2).

5.5 The Public Works Loans Board (PWLB) provides a facility to restructure debt, including early repayment of loans and encourages local authorities to do so when circumstances permit. This can result in net savings in overall interest charges. Current circumstances do not suggest that refinancing existing PWLB debt would be economically prudent due to the significant repayment penalties. However prevailing PWLB interest rates continue to be monitored in order to identify repayment opportunities.

6. Other

6.1 In December 2017, the Chartered Institute of Public Finance and Accountancy, (CIPFA), issued revised Prudential and Treasury Management Codes. As from 2019/20, all local authorities are required to prepare a Capital Strategy which is intended to provide the following: -

- a high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services;
- an overview of how the associated risk is managed;
- the implications for future financial sustainability.

A report setting out our Capital Strategy is included in the Medium-Term Financial Plan 2021/25 which was presented to the Police and Crime Panel on 29 January 2021.

6.2 MiFID II (Markets in Financial Instruments Directive).
On 3 January 2018 the EU introduced regulations under MiFID II. These regulations govern the relationship that financial institutions conducting lending and borrowing transactions have with local authorities (and PCCs). This has little effect on the PCC apart from having to fill in forms sent by each institution dealing with the PCC and for each type of investment instrument in use - apart from for cash deposits with banks and building societies.

7. Conclusion

7.1 The Mid-Year Treasury Management Monitoring Report 2020/21 provides information on the Treasury Management activities of the PCC for the period 1 April 2020 to 30 September 2020.

8. Recommendation

8.1 It is recommended that Audit Committee and PCC note the Mid-Year Treasury Management Monitoring Report 2020/21.

Appendix 2

The Office of the Police and Crime Commissioner for Suffolk
Annual Investment and Treasury Management Strategy Statement 2021/22

1. Background

1.1 The PCC is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. Part of the treasury management operation is to ensure that this cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in low risk counterparties or instruments commensurate with the PCC's low risk appetite, providing adequate liquidity initially before considering investment return.

1.2 The second main function of the treasury management service is the funding of the PCC's capital plans. These capital plans provide a guide to the borrowing need of the PCC, essentially the longer-term cash flow planning, to ensure that the PCC can meet his capital spending obligations. This management of longer-term cash may involve arranging long or short-term loans, or using longer-term cash flow surpluses. On occasion, when it is prudent and economic, any debt previously drawn may be restructured to meet PCC risk or cost objectives.

1.3 The contribution the treasury management function makes to the PCC is critical, as the balance of debt and investment operations ensure liquidity or the ability to meet spending commitments as they fall due, either on day-to-day revenue or for larger capital projects. The treasury operations will see a balance of the interest costs of debt and the investment income arising from cash deposits affecting the available budget. Since cash balances generally result from reserves and balances, it is paramount to ensure adequate security of the sums invested, as a loss of principal will in effect result in a loss to the General Fund Balance.

1.4 CIPFA defines treasury management as:

"The management of the local authority's borrowing, 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."

1.5 This PCC has not engaged in any commercial investments and has no non-treasury investments.

2. Reporting requirements

Capital Strategy

2.1 The CIPFA 2017 Prudential and Treasury Management Codes require, for 2021/22, all local authorities to prepare a capital strategy report, which will provide the following:

- A high-level long-term overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services;
- An overview of how the associated risk is managed;
- The implications for future financial sustainability.

2.2 The aim of this capital strategy is to ensure that the PCC fully understands the overall long-term policy objectives and resulting capital strategy requirements, governance procedures and risk appetite.

2.3 The Capital Strategy will be published separately but is included within the PCC's Budget and MTFP report.

Treasury Management reporting

2.4 The PCC is currently required to receive and approve, as a minimum, three main treasury reports each year, which incorporate a variety of policies, estimates and actuals.

a) **Prudential and treasury indicators and treasury strategy** (this report) - The first, and most important report is forward looking and covers:

- the capital plans, (including prudential indicators); (Para E58);
- a minimum revenue provision (MRP) policy, (how unfunded capital expenditure is charged to revenue over time); (Appendix H);
- the treasury management strategy, (how the investments and borrowings are to be organised), including treasury indicators; and
- an investment strategy, (the parameters on how investments are to be managed).

b) **A mid-year treasury management report** – This is primarily a progress report and will update the PCC on the capital position, amending prudential indicators as necessary, and whether any policies require revision.

c) **An annual treasury report** – This is a backward looking review document and provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

3. Treasury Management Strategy for 2021/22

3.1 The strategy for 2021/22 covers two main areas:

Capital issues

- the capital expenditure plans and the associated prudential indicators; see Annex 1.
- the minimum revenue provision (MRP) policy. See Annex 2.

Treasury management issues

- the current treasury position;
- treasury indicators which limit the treasury risk and activities of the PCC;
- prospects for interest rates;
- the borrowing strategy;
- policy on borrowing in advance of need;
- debt rescheduling;
- the investment strategy;
- creditworthiness policy; and
- the policy on use of external service providers.

These elements cover the requirements of the Local Government Act 2003, the CIPFA Prudential Code, MHCLG MRP Guidance, the CIPFA Treasury Management Code and MHCLG Investment Guidance.

Training

3.2 The CIPFA Code requires the responsible officer to ensure that officers with responsibility for treasury management receive adequate training in treasury management. This also applies to Audit Committee members responsible for scrutiny. Training on the Prudential Code and the Capital Strategy was provided to Audit Committee members in October 2018.

Treasury management consultants

3.3 The PCC uses Link Asset Services as its external treasury management advisors. The current contract with Link expires on 31 August 2022.

3.4 The PCC recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon the services of our external service providers. All decisions will be undertaken with regard to all available information, including, but not solely, our treasury advisers.

3.5 It is also recognised that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The PCC will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review.

The Treasury Management Function

3.6 The CIPFA Code defines treasury management activities as "the management of the PCC'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."

3.7 The 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 PCC, and any financial instruments entered into to manage these risks.

3.8 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 value for money in treasury management, and to employing suitable comprehensive performance measurement techniques, within the context of effective risk management.

3.9 The PCC is required to operate a balanced budget, which broadly means that cash raised during the year will meet its cash expenditure. Part of the treasury management operations ensures this cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in low risk counterparties, providing adequate liquidity before considering investment return.

3.10 A further function of the treasury management service is to provide for the borrowing requirement of the PCC, essentially the longer-term cash flow planning, typically 30 years plus, to ensure the PCC can meet its capital spending obligations. This management of longer-term cash may involve arranging long or short-term loans, or using internal cash balances on a temporary basis. Debt previously borrowed may be restructured to meet PCC risk or cost objectives.

3.11 The PCC has delegated responsibility for treasury management decisions taken within the approved strategy to the PCC CFO. Day to day execution and administration of investment and borrowing decisions is undertaken by Specialist Accountants based in the Joint Finance Department for Suffolk and Norfolk Constabularies.

3.12 External treasury management services continue to be provided by Link Asset Services in a joint contract with the PCC for Norfolk. Link Asset Services provides a range of services which include:

- Technical support on treasury matters and capital finance issues;
- Economic and interest rate analysis;
- Debt services which includes advice on the timing of long-term borrowing;
- Debt rescheduling advice surrounding the existing portfolio;
- Generic investment advice on interest rates, timing and investment instruments;
- Credit ratings/market information service for the three main credit rating agencies (Fitch, Moody's and Standard & Poors).

3.13 Whilst Link Asset Services provide support to the treasury function, under market rules and in accordance with the CIPFA Code of Practice, the final decision on treasury matters remains with the PCC.

3.14 Performance will continue to be monitored and reported to the PCC as part of the budget monitoring report.

3.15 Link Asset Service's Economic Forecast is set out in Annex 3.

4. Investment Strategy 2021/22

4.1 Bank Rate is unlikely to rise from 0.10% for a considerable period. It is very difficult to say when it may start rising so it may be best to assume that investment earnings from money market-related instruments will be sub 0.50% for the foreseeable future.

- Q1 2021 - 0.10%
- Q1 2022 - 0.10%
- Q1 2023 - 0.10%

4.2 The suggested budgeted investment earnings rates for returns on investments placed for periods up to about three months during each financial year are as follows:

Financial Year	Budgeted Interest Earnings
2020/21	0.1%
2021/22	0.1%

2022/23	0.1%
2023/24	0.1%
2024/25	0.25%
Later Years	2.00%

4.3 The overall balance of risks to economic growth in the UK is probably to the downside due to the weight of all the uncertainties over Brexit, as well as a softening global economic picture.

4.4 The overall balance of risks to economic growth in the UK is probably now skewed to the upside, but is subject to major uncertainty due to the virus and how quickly successful vaccines may become available and widely administered to the population. It may also be affected by what, if any, deal the UK agrees as part of Brexit.

4.5 There is relatively little UK domestic risk of increases or decreases in Bank Rate and significant changes in shorter term PWLB rates. The Bank of England has effectively ruled out the use of negative interest rates in the near term and increases in Bank Rate are likely to be some years away given the underlying economic expectations. However, it is always possible that safe haven flows, due to unexpected domestic developments and those in other major economies, or a return of investor confidence in equities, could impact gilt yields, (and so PWLB rates), in the UK.

4.6 While the Bank of England said in August / September 2020 that it is unlikely to introduce a negative Bank Rate, at least in the next 6 -12 months, and in November omitted any mention of negative rates in the minutes of the meeting of the Monetary Policy Committee, some deposit accounts are already offering negative rates for shorter periods. As part of the response to the pandemic and lockdown, the Bank and the Government have provided financial markets and businesses with plentiful access to credit, either directly or through commercial banks. In addition, the Government has provided large sums of grants to local authorities to help deal with the COVID crisis; this has caused some local authorities to have sudden large increases in cash balances searching for an investment home, some of which was only very short term until those sums were able to be passed on.

4.7 As for money market funds (MMFs), yields have continued to drift lower. Some managers have already resorted to trimming fee levels to ensure that net yields for investors remain in positive territory where possible and practical. Investor cash flow uncertainty, and the need to maintain liquidity in these unprecedented times, has meant there is a surfeit of money swilling around at the very short end of the market. This has seen a number of market operators, now including the DMADF, offer nil or negative rates for very short-term maturities. This is not universal, and MMFs are still offering a marginally positive return, as are a number of financial institutions for investments at the very short end of the yield curve.

4.8 Inter-local authority lending and borrowing rates have also declined due to the surge in the levels of cash seeking a short-term home at a time when many local authorities are probably having difficulties over accurately forecasting when disbursements of funds received will occur or when further large receipts will be received from the Government.

4.9 There are 3 key considerations to the treasury management investment process. MHCLG's Investment Guidance ranks these in the following order of importance:

- security of principal invested;
- liquidity for cash flow, and
- investment return (yield).

Each deposit is considered in the context of these 3 factors, in that order.

4.10 MHCLG's Investment Guidance requires local authorities and PCCs to invest prudently and give priority to security and liquidity before yield, as described above. In order to facilitate this objective, the Guidance requires the PCC to have regard to CIPFA's Code of Practice for Treasury Management in the Public Sector.

4.11 The key requirements of both the Code and the Investment Guidance are to produce an Annual Investment and Treasury Strategy covering the following:

- Guidelines for choosing and placing investments – Counterparty Criteria and identification of the maximum period for which funds can be committed – Counterparty Monetary and Time Limits;
- Details of Specified and Non-Specified investment types.

5. Investment Strategy 2021/22 - Counterparty Criteria

5.1 The PCC works closely with its external treasury advisors to determine the criteria for high quality institutions.

5.2 The criteria for providing a pool of high-quality investment counterparties for inclusion on the PCC's 'Approved Authorised Counterparty List' is provided below

- **UK Banks** which have the following minimum ratings from at least one of the three credit rating agencies:

UK Banks	**Fitch**	**Standard & Poors**	**Moody's**
Short Term Ratings	F1	A-1	P-1
Long Term Ratings	A-	A-	A3

- **Non-UK Banks** domiciled in a country which has a minimum sovereign rating of AA+ and have the following minimum ratings from at least one of the credit rating agencies:

Non-UK Bank	**Fitch**	**Standard & Poors**	**Moody's**
Short Term Ratings	F1+	A-1+	P-1
Long Term Ratings	AA-	AA-	Aa3

- **Part Nationalised UK Banks –** Royal Bank of Scotland Group (including Nat West). These banks are included while they continue to be part nationalised or they meet the minimum rating criteria for UK Banks above.

- **The PCC's Corporate Banker –** If the credit ratings of the PCC's corporate banker (currently Lloyds Bank plc) fall below the minimum criteria for UK Banks above, then cash balances held with that bank will be for account operation purposes only and balances will be minimised in terms of monetary size and time.

- **Building Societies –** The PCC will use Building Societies which meet the ratings for UK Banks outlined above.

- **Money Market Funds (MMFs) –** which are rated AAA by at least one of the three major rating agencies. MMF's are 'pooled funds' investing in high-quality, high-liquidity, short-term securities such as treasury bills, repurchase agreements and certificate of deposit. Funds offer a high degree of counterparty diversification that include both UK and Overseas Banks.

- **UK Government –** including the Debt Management Account Deposit Facility & Sterling Treasury Bills. Sterling Treasury Bills are short-term (up to six months) 'paper' issued by the UK Government. In the same way that the Government issues Gilts to meet long term funding requirements, Treasury Bills are used by Government to meet short term revenue obligations. They have the security of being issued by the UK Government.

- **Local Authorities, PCCs etc. –** Includes those in England and Wales (as defined in Section 23 of the Local Government Act 2003) or a similar body in Scotland or Northern Ireland.

5.3 All cash invested by the PCC in 2021/22 will be either Sterling deposits (including certificates of deposit) or Sterling Treasury Bills invested with banks and other institutions in accordance with the Approved Authorised Counterparty List.

5.4 The Code of Practice requires local authorities and PCCs to supplement credit rating information. Whilst the above criteria rely primarily on the application of credit ratings to provide a pool of appropriate counterparties for use, additional market information will be used to inform investment decisions. This additional market information includes, for example, Credit Default Swap rates and equity prices in order to compare the relative security of counterparties.

5.5 The current maximum lending limit of £10m for any counterparty will be maintained in 2021/22 to reflect the level of cash balances and to avoid large deposits with the DMO. Where there is a surplus of cash due to unplanned cashflows, in order to keep within the counterparty limit with the PCC's bankers, the PCC will place investments using other secure liquid financial instruments, e.g. Money Market Funds.

5.6 In addition to individual institutional lending limits, "Group Limits" will be used whereby the collective investment exposure of individual banks within the same banking group is restricted to a group lending limit of £10m.

5.7 The Strategy permits deposits beyond 365 days (up to a maximum of 2 years) but only with UK banks which meet the credit ratings at paragraph 5.2. Deposits may also be placed with UK Part Nationalised Banks and Local Authorities for periods of up to 2 years.

5.8 A reasonable amount will be held on an instant access basis in order for the PCC to meet any unexpected needs. Instant access accounts are also preferable during periods of credit risk uncertainty in the markets, allowing the PCC to immediately withdraw funds should any concern arise over a particular institution.

6. Investment Strategy 2021/22 – Specified and Non-Specified Investments

6.1 As determined by CLG's Investment Guidance, Specified Investments offer "high security and high liquidity". They are Sterling denominated and have a maturity of less than one year or for a longer period but where the PCC has the right to be repaid within one year if he wishes. Institutions of "high" credit quality are deemed to be Specified Investments where the possibility of loss of principal or investment income is small. From the pool of high-quality investment counterparties identified in Section 5, the following are deemed to be Specified Investments:

- Banks: UK and Non-UK;
- Part Nationalised UK Banks;
- The PCC's Corporate Banker (Lloyds Bank plc)
- Building Societies (which meet the minimum ratings criteria for Banks);
- Money Market Funds;
- UK Government;
- Local Authorities, PCCs etc.

6.2 Non-Specified Investments are those investments that do not meet the criteria of Specified Investments. From the pool of counterparties identified in Section 5, they include:

- Any investment that cannot be recalled within 365 days of initiation.

6.3 The categorisation of 'Non-Specified' does not in any way detract from the credit quality of these institutions, but is merely a requirement of the Government's guidance.

6.4 The PCC's proposed Strategy for 2021/22 therefore includes both Specified and Non-Specified Investment institutions.

7. Borrowing Strategy 2021/22

7.1 Capital expenditure can be funded immediately by applying capital receipts, capital grants or revenue contributions. Capital expenditure in excess of available capital resources or revenue contributions will increase the PCC's borrowing requirement. The PCC's need to borrow is measured by the Capital Financial Requirement (CFR), which simply represents the total outstanding capital expenditure, which has not yet been funded from either capital or revenue resources.

7.2 For the PCC, borrowing principally relates to long term loans (i.e. loans in excess of 365 days). The borrowing strategy includes decisions on the timing of when further monies should be borrowed.

7.3 Historically, the main source of long-term loans has been the Public Works Loan Board (PWLB), which is part of the UK Debt Management Office (DMO). The maximum period for which loans can be advanced by the PWLB is 50 years. On 26 November 2020, HM Treasury reversed the increase of 100 basis points that took place on 9 October 2019, following a response to a consultation that was published on 25 November 2020. Lending by the PWLB is now on the proviso that CFOs confirm that the authority does not intend to buy investment assets primarily for yield at any point in the next three years.

7.4 External borrowing currently stands at £7.09m (excluding PFI). At 31 March 2020 there was a £13.6m Capital Financing Requirement (CFR) relating to unfunded capital expenditure which had been financed from internal resources. The CFR is estimated to be £13.9m at 31 March 2021, £17.9m at 31 March 2022 and £18.0m at 31 March 2023. Additional long term borrowing is estimated at £0.0m for 2021/22, £0.0m for 2022/23 and £0.4m for 2023/24. The borrowing requirement does not include the funding requirement in respect of assets financed through PFI.

7.5 The challenging and uncertain economic outlook outlined by Link Asset Services in Annex 3, together with managing the cost of "carrying debt" requires a flexible approach to borrowing. The PCC, under delegated powers, will take the most appropriate form of borrowing depending on the prevailing interest rates at the time, considering the risks identified in Link Asset Services economic overview (Section 3).

7.6 The level of outstanding debt and composition of debt, in terms of individual loans, is kept under review. The PWLB provides a facility to allow the restructure of debt, including premature repayment of loans, and encourages local authorities and PCCs to do so when circumstances permit. This can result in net savings in overall interest charges. The PCC CFO and Link Asset Services will monitor prevailing rates for any opportunities during the year. As short-term borrowing rates will be considerably cheaper than longer term fixed interest rates, there may be potential opportunities to generate savings by switching from long term debt to short term debt. However, these savings will need to be considered in the light of the current treasury position and the size of the cost of debt repayment (premiums incurred). Consideration will also be given to identify if there is any residual potential for making savings by running down investment balances to repay debt prematurely as short-term rates on investments are likely to be lower than rates paid on current debt

7.7 The PCC has flexibility to borrow funds in the current year for use in future years, but will not borrow more than or in advance of its needs purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be within forward approved Capital Financing Requirement estimates, and will be considered carefully to ensure that value for money can be demonstrated and that the PCC can ensure the security of such funds

7.8 The PCC will continue to use the most appropriate source of borrowing at the time of making application, including; the PWLB, commercial market loans, Local Authorities and the Municipal Bond Agency.

8. Treasury Management Prudential Indicators

8.1 In addition to the key Treasury Indicators included in the Prudential Code and reported separately, there are two treasury management indicators. The purpose of the indicators is to restrict the activity of the treasury function to within certain limits, thereby managing risk and reducing the impact of an adverse movement in interest rates. However, if these indicators are too restrictive, they will impair the opportunities to reduce costs/improve performance. The Indicators are:

- **Maturity Structures of Borrowing** – These gross limits are set to reduce the PCC's exposure to large fixed rate sums falling due for refinancing and require upper and lower limits. It is recommended that the PCC sets the following limits for the maturity structures of its borrowing at 31.3.21:

	Actual*	**Lower Limit**	**Upper Limit**
Under 12 months	5.0%	0%	15%
12 months and within 24 months	5.3%	0%	15%
24 months and within 5 years	17.2%	0%	45%
5 years and within 10 years	34.3%	0%	75%
10 years and above	38.2%	0%	100%

* Actual is based on existing balances at 16.12.20

- **Upper Limits to the Total of Principal Funds Invested for Greater than 365 Days –** This limit is set with regard to the PCC's liquidity requirements. It is estimated that in 2021/22, the maximum level of PCC funds invested for periods greater than 365 days will be no more than £4m.

Annex A

Prudential Code Indicators 2021/22, 2022/23, 2023/24

1. Background

1.1 The Prudential Code for capital investment came into effect on 1st April 2004. It replaced the complex regulatory framework, which only allowed borrowing if specific government authorisation had been received. The Prudential system is one based on self-regulation. All borrowing undertaken is self-determined under the prudential code. A revised Prudential Code was published in December 2017 and was applied from 2018/19.

1.2 Under Prudential arrangements the PCC can determine the borrowing limit for capital expenditure. The Government does retain reserve powers to restrict borrowing if that is required for national economic reasons.

1.3 The key objectives of the Code are to ensure, within a clear framework, that capital investment plans are affordable, prudent and sustainable. The Code specifies indicators that must be used and factors that must be taken into account. The Code requires the PCC to set and monitor performance on:

- capital expenditure;
- affordability;
- external debt;
- treasury management (now included within Treasury Management strategy).

1.4 The required indicators are:

- Capital Expenditure Forecast;
- Capital Financing Requirement;
- Actual External Debt;
- Authorised Limit for External Debt;
- Operational Boundary Limit for External Debt .

However, authorities are now advised to use local indicators, where this would be beneficial, especially if carry out commercial activities.

1.5 Once determined, the indicators can be changed so long as this is reported to the PCC.

1.6 Actual performance against indicators will be monitored throughout the year. All the indicators will be reviewed and updated annually.

2. The Indicators

2.1 The **Capital Expenditure Payment Forecast** is detailed in Appendix D of the PCC's Budget and MTFP report 2021/25. The total estimated payments are:

	2021/22	2022/23	2023/24
	£m	£m	£m
Capital Expenditure Forecast	8.511	3.688	5.650

The PCC is being asked for approval to an overall Capital Programme based on the level of capital financing costs contained within the draft revenue budget.

2.2 The **ratio of capital financing costs to net revenue budget** shows the estimated annual revenue costs of borrowing (net interest payable on debt and the minimum revenue provision for repaying the debt), as a proportion of annual income from local taxation and non-specific government grants. The estimates include PFI MRP and interest costs. Estimates of the ratio of capital financing costs to net revenue budget for future years are:

Ratio of Capital Financing Costs to Net Revenue Budget		
2021/22 Estimate	2022/23 Estimate	2023/24 Estimate
2.23%	2.41%	2.52%

2.3 The **capital financing requirement** represents capital expenditure not yet financed by capital receipts, revenue contributions or capital grants. It measures the underlying need to borrow for capital purposes, although this borrowing may not necessarily take place externally. Estimates of the end of year capital financing requirement for future years are:

Capital Financing Requirement			
31/03/21 Estimate	31/03/22 Estimate	31/03/23 Estimate	31/03/24 Estimate
£35.307m	£38.868m	£38.384m	£38.868m

2.4 The guidance on **net borrowing for capital purposes** advises that:

"In order to ensure that over the medium term net borrowing will only be for a capital purpose, the PCC should ensure that net external borrowing does not, except in the short term, exceed the total of capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years."

2.5 Net borrowing refers to the PCC's total external borrowing net of any temporary cash investments and must work within this requirement.

2.6 The Code defines the **authorised limit for external debt** as the sum of external borrowing and any other financing long-term liabilities e.g. finance leases. It is recommended that the PCC approve the 2021/22 and future years limits. For 2021/22 this will be the statutory limit determined under section 3(1) of the Local Government Act 2003.
As required by the Code, the PCC is asked to delegate authority to the Chief Finance Officer

(OPCCS), within the total limit for any individual year, to effect movement between the separate limits for borrowing and other long-term liabilities. Any such changes made will be reported to the PCC.

Authorised Limit for External Debt			
	2021/22	2022/23	2023/24
	£m	£m	£m
PWLB borrowing	6.853	6.474	6.495
Other long term liabilities (PIC PFI)	21.006	20.340	19.632
Headroom	12.953	13.489	14.685
Total	40.811	40.303	40.811

These proposed limits are consistent with the Capital Programme. They provide headroom to allow for operational management, for example unusual cash movements.

2.7 The Code also requires the PCC to approve an **operational boundary limit for external debt** for the same time period. The proposed operational boundary for external debt is the same calculation as the authorised limit without the additional headroom. The operational boundary represents a key management tool for in year monitoring.

2.8 Within the operational boundary, figures for borrowing and other long-term liabilities are separately identified again. The PCC is asked to delegate authority to the Chief Finance Officer (OPCCS), within the total operational boundary for any individual year, to make any required changes between the separately agreed figures for borrowing and other long-term liabilities. Any changes will be reported to the PCC.

Operational Boundary Limit for External Debt			
	2021/22	2022/23	2023/24
	£m	£m	£m
PWLB borrowing	6.853	6.474	6.495
Other long term liabilities (PIC PFI)	21.006	20.340	19.632
Total	27.858	26.814	26.127

Minimum Revenue Provision (MRP)
MRP Policy and Statement for 2021/22

1. Introduction

1.1 The PCC is required to make a charge against the revenue budget each year in respect of capital expenditure financed by borrowing or credit arrangement. The annual charge is set aside for the eventual repayment of the loan and is known as the Minimum Revenue Provision (MRP). This is separate from any annual interest charges that are incurred on borrowing.

1.2 The Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2008 amend the way in which MRP can be calculated so that each authority must consider what is "prudent". The regulations are backed up by statutory guidance which gives advice on what might be considered prudent.

2. Options for Making Prudent Provision

2.1 Four options are included in the guidance, which are those likely to be most relevant for the majority of local government bodies. Although other approaches are not ruled out, local government bodies must demonstrate that they are fully consistent with the statutory duty to make prudent revenue provision.

Option 1 - Regulatory Method
Authorities may continue to use the formulae put in place by the previous regulations.

Option 2 - Capital Financing Requirement (CFR) Method

Under this option, MRP is equal to 4% of the non-housing CFR at the end of the preceding financial year.

Option 3 – Asset Life Method
This is to make provision over the estimated life of the asset for which the borrowing is undertaken. This could be done by:

a) Charging MRP in equal instalments over the life of the asset
b) Charge MRP on an annuity basis, where MRP is the principal element for the year of the annuity required to repay over the asset's useful life the amount of capital expenditure financed by borrowing or credit arrangements. The authority should use an appropriate interest rate to calculate the amount. Adjustments to the calculation to take account of repayment by other methods during repayment period (e.g. by the application of capital receipts) should be made as necessary.

Option 4 - Depreciation
MRP is deemed to be equal to the provision required in accordance with deprecation accounting in respect of the asset on which expenditure has been financed by borrowing or credit arrangements. This should include any amount for impairment charged to the income and expenditure accounts.

2.2 The regulations make a distinction between capital expenditure incurred before 1 April 2008 and capital expenditure incurred from 1 April 2008 in terms of the options available.

2.3 Options 1 and 2 are to be used for capital expenditure incurred pre April 2008. Options 3 and 4 are to be used for Capital expenditure incurred post April 2008.

3. MRP Policy

3.1 Before 1 April 2019 the option adopted for expenditure incurred after 1 April 2008 was Option 3a (Equal Instalment method). This method was deemed prudent whilst assets were primarily being internally financed.

3.2 As reserves, cash and investment balances have been consumed following the decrease in direct government funding, it is now necessary to externally finance capital expenditure on long life assets. The current preferred financing method is via the Public Works Loans Board (PWLB) borrowed on an annuity basis.

3.3 Option 3b (Annuity Method) is adopted for capital expenditure chargeable as MRP for the first time after 1 April 2019. The principal reason for this change was for the charge to revenue to reflect the capital repayment basis on the associated finance. This method will therefore adopt a similar MRP basis as those assets financed through lease or PFI arrangements.

3.4 The revised Statutory Guidance released on 2 February 2018 stipulates that this change in policy cannot be applied retrospectively to assets placed in service prior to the date the revised policy was introduced. Therefore, Option 3a still applies to capital expenditure chargeable as MRP for the first time prior to 1 April 2019.

4. Recommendations

4.1 It is proposed that the following MRP policy is adopted as follows for 2021/22:

- Capital expenditure incurred before April 2008 is treated in accordance with Option 1 of the regulatory guidance;
- Capital expenditure chargeable as MRP for the first time from 1 April 2008 to 31 March 2019 is treated in accordance with Option 3(a) of the regulatory guidance.
- Capital expenditure chargeable as MRP for the first time after 1 April 2019 is treated in accordance with Option 3(b) of the regulatory guidance.