

**The Office of the Police and Crime Commissioner for Suffolk
Annual Investment and Treasury Management Strategy Statement 2019/20**

1.1 Introduction

Background

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.

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.

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.

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."

Revised reporting is required for the 2019/20 reporting cycle due to revisions of the Ministry of Housing, Communities and Local Government (MHCLG) Investment Guidance, the MHCLG Minimum Revenue Provision (MRP) Guidance, the CIPFA Prudential Code and the CIPFA Treasury Management Code. The primary reporting changes include the introduction of a capital strategy, to provide a longer-term focus to the capital plans, and greater reporting requirements surrounding any commercial activity undertaken under the Localism Act 2011. The capital strategy is being reported separately.

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

Reporting requirements

1.2 Capital Strategy

The CIPFA revised 2017 Prudential and Treasury Management Codes require, for 2019-20, all local authorities to prepare an additional report, 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

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.

1.3 Treasury Management reporting

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);
 - a minimum revenue provision (MRP) policy, (how unfunded capital expenditure is charged to revenue over time);
 - 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.

Treasury Management Strategy for 2019/20

The strategy for 2019/20 covers two main areas:

Capital issues

- the capital expenditure plans and the associated prudential indicators;
- the minimum revenue provision (MRP) policy.

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

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.

Treasury management consultants

The PCC uses Link Asset Services, Treasury solutions as its external treasury management advisors.

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 regards to all available information, including, but not solely, our treasury advisers.

It also recognises 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.

2. The Treasury Management Function

- 2.1 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.”

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.

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.

- 2.2 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.
- 2.3 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.

- 2.4 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.
- 2.5 External treasury management services continue to be provided by Link Asset Services in a joint contract with the PCC for Suffolk. 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).
- 2.6 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.
- 2.7 Performance will continue to be monitored and reported to the PCC as part of the budget monitoring report.

3. Link Asset Services Economic Forecast

ECONOMIC BACKGROUND

GLOBAL OUTLOOK. World growth has been doing reasonably well, aided by strong growth in the US. However, US growth is likely to fall back in 2019 and, together with weakening economic activity in China, overall world growth is likely to weaken.

Inflation has been weak during 2018 but, at long last, unemployment falling to remarkably low levels in the US and UK has led to a marked acceleration of wage inflation which is likely to prompt central banks into a series of increases in central rates. The EU is probably about a year behind in a similar progression.

KEY RISKS - central bank monetary policy measures

Looking back on nearly ten years since the financial crash of 2008 when liquidity suddenly dried up in financial markets, it can be assessed that central banks' monetary policy measures to counter the sharp world recession were successful. The key monetary policy measures they used were a combination of lowering central interest rates and flooding financial markets with liquidity, particularly through unconventional means such as quantitative easing (QE), where central banks bought large amounts of central government debt and smaller sums of other debt.

The key issue now is that that period of stimulating economic recovery and warding off the threat of deflation, is coming towards its close. A new period has already started in the US, and more recently in

the UK, of reversing those measures i.e. by raising central rates and, (for the US), reducing central banks' holdings of government and other debt. These measures are now required in order to stop the trend of a reduction in spare capacity in the economy, and of unemployment falling to such low levels that the re-emergence of inflation is viewed as a major risk. It is, therefore, crucial that central banks get their timing right and do not cause shocks to market expectations that could destabilise financial markets. In particular, a key risk is that because QE-driven purchases of bonds drove up the price of government debt, and therefore caused a sharp drop in income yields, this also encouraged investors into a search for yield and into investing in riskier assets such as equities. Consequently, prices in both bond and equity markets rose to historically high valuation levels simultaneously. This now means that both asset categories are vulnerable to a sharp downward correction. It is important, therefore, that central banks only gradually unwind their holdings of bonds in order to prevent destabilising the financial markets. It is also likely that the timeframe for central banks unwinding their holdings of QE debt purchases will be over several years. They need to balance their timing to neither squash economic recovery, by taking too rapid and too strong action, or, conversely, let inflation run away by taking action that was too slow and/or too weak. **The potential for central banks to get this timing and strength of action wrong are now key risks.**

The world economy also needs to adjust to a sharp change in **liquidity creation** over the last five years where the US has moved from boosting liquidity by QE purchases, to reducing its holdings of debt. In addition, the European Central Bank has cut back its QE purchases substantially and made a decision to end them completely in December 2018.

UK. The flow of positive economic statistics since the end of the first quarter this year has shown that pessimism was overstated about the poor growth in quarter 1 when adverse weather caused a temporary downward blip. Quarter 1 at 0.1% growth in GDP was followed by a return to 0.4% in quarter 2; quarter 3 is expected to be robust at around +0.6% but quarter 4 is expected to weaken from that level.

At their November meeting, the Monetary Policy Committee (MPC) repeated their well-worn phrase that future Bank Rate increases would be gradual and would rise to a much lower equilibrium rate, (where monetary policy is neither expansionary or contractionary), than before the crash; indeed they gave a figure for this of around 2.5% in ten years time but declined to give a medium term forecast. However, with so much uncertainty around Brexit, they warned that the next move could be up or down, even if there was a disorderly Brexit. While it would be expected that Bank Rate could be cut if there was a significant fall in GDP growth as a result of a disorderly Brexit, so as to provide a stimulus to growth, they warned they could also *raise* Bank Rate in the same scenario if there was a boost to inflation from a devaluation of sterling, increases in import prices and more expensive goods produced in the UK replacing cheaper goods previously imported, and so on. In addition, the Chancellor has held back some spare capacity to provide a further fiscal stimulus if needed.

It is unlikely that the MPC would increase Bank Rate in February 2019, ahead of the deadline in March for Brexit. Getting parliamentary approval for a Brexit agreement on both sides of the Channel will take well into spring next year. However, in view of the hawkish stance of the MPC at their November meeting, the next increase in Bank Rate is now forecast to be in May 2019. The following increases are then forecast to be in February and November 2020 before ending up at 2.0% in February 2022.

Inflation. The Consumer Price Index (CPI) measure of inflation has been falling from a peak of 3.1% in November 2017 to 2.4% in October. In the November Bank of England quarterly inflation report, inflation was forecast to still be marginally above its 2% inflation target two years ahead, (at about 2.1%), given a scenario of minimal increases in Bank Rate. This inflation forecast is likely to be amended upwards due to the Bank's inflation report being produced prior to the Chancellor's announcement of a significant fiscal stimulus in the Budget; this is likely to add 0.3% to GDP growth at a time when there is little spare capacity left in the economy, particularly of labour.

As for the **labour market** figures in September, unemployment at 4.1% was marginally above a 43 year low of 4% on the Independent Labour Organisation measure. A combination of job vacancies hitting an all-time high, together with negligible growth in total employment numbers, indicates that employers are now having major difficulties filling job vacancies with suitable staff. It was therefore unsurprising that wage inflation picked up to 3.2%, (3 month average regular pay, excluding bonuses). This meant that in real terms, (i.e. wage rates less CPI inflation), earnings are currently growing by about 0.8%, the highest level since 2009. This increase in household spending power is likely to feed through into providing some support to the overall rate of economic growth in the coming months. This tends to confirm that the MPC was right to start on a cautious increase in Bank Rate in August as it views wage inflation in excess of 3% as increasing inflationary pressures within the UK economy.

In the **political arena**, there is a risk that the current Conservative minority government may be unable to muster a majority in the Commons over Brexit. However, our central position is that Prime Minister May's government will endure, despite various setbacks, along the route to reaching an orderly Brexit in March 2019. If, however, the UK faces a general election in the next 12 months, this could result in a potential loosening of monetary and fiscal policy and therefore medium to longer dated gilt yields could rise on the expectation of a weak pound and concerns around inflation picking up.

USA. President Trump's massive easing of fiscal policy is fuelling a, (temporary), boost in consumption which has generated an upturn in the rate of strong growth which rose from 2.2%, (annualised rate), in quarter 1 to 4.2% in quarter 2 and 3.5%, (3.0% y/y), in quarter 3, but also an upturn in inflationary pressures. In particular, wage rates were increasing at 3.1% y/y in October and heading higher due to unemployment falling to a 49 year low of 3.7%. With CPI inflation over the target rate of 2% and on a rising trend towards 3%, the Fed increased rates another 0.25% in September to between 2.00% and 2.25%, this being the fourth increase in 2018. They also indicated that they expected to increase rates four more times by the end of 2019. The dilemma, however, is what to do when the temporary boost to consumption wanes, particularly as the recent imposition of tariffs on a number of countries' exports to the US, (China in particular), could see a switch to US production of some of those goods, but at higher prices. Such a scenario would invariably make any easing of monetary policy harder for the Fed in the second half of 2019. However, a combination of an expected four increases in rates of 0.25% by the end of 2019, together with a waning of the boost to economic growth from the fiscal stimulus in 2018, could combine to depress growth below its potential rate, i.e. monetary policy may prove to be too aggressive and lead to the Fed having to start on cutting rates. The Fed has also been unwinding its previous quantitative easing purchases of debt by gradually increasing the amount of monthly maturing debt that it has not been reinvesting.

The tariff war between the US and China has been generating a lot of heat during 2018, but it is not expected that the current level of actual action would have much in the way of a significant effect on US or world growth. However, there is a risk of escalation. The results of the mid-term elections are not expected to have a material effect on the economy.

Eurozone. Growth was 0.4% in quarters 1 and 2 but fell back to 0.2% in quarter 3, though this is probably just a temporary dip. In particular, data from Germany has been mixed and it could be negatively impacted by US tariffs on a significant part of manufacturing exports e.g. cars. For that reason, although growth is still expected to be in the region of nearly 2% for 2018, the horizon is less clear than it seemed just a short while ago. Having halved its quantitative easing purchases of debt in October 2018 to €15bn per month, the European Central Bank announced in December 2018 to end all further purchases. Inflationary pressures are starting to build gently so it is expected that the ECB will start to increase rates towards the end of 2019.

China. Economic growth has been weakening over successive years, despite repeated rounds of central bank stimulus; medium term risks are increasing. Major progress still needs to be made to eliminate excess industrial capacity and the stock of unsold property, and to address the level of non-performing loans in the banking and credit systems. Progress has been made in reducing the rate of credit creation, particularly from the shadow banking sector, which is feeding through into lower economic growth. There are concerns that official economic statistics are inflating the published rate of growth.

Japan - has been struggling to stimulate consistent significant GDP growth and to get inflation up to its target of 2%, despite huge monetary and fiscal stimulus. It is also making little progress on fundamental reform of the economy. It is likely that loose monetary policy will endure for some years yet to try to stimulate growth and modest inflation.

Emerging countries. Argentina and Turkey are currently experiencing major headwinds and are facing challenges in external financing requirements well in excess of their reserves of foreign exchange. However, these countries are small in terms of the overall world economy, (around 1% each), so the fallout from the expected recessions in these countries will be minimal.

INTEREST RATE FORECASTS

Link Asset Services Interest Rate View														
	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22
Bank Rate View	0.75%	0.75%	1.00%	1.00%	1.00%	1.25%	1.25%	1.25%	1.50%	1.50%	1.75%	1.75%	1.75%	2.00%
3 Month LIBID	0.80%	0.90%	1.00%	1.10%	1.20%	1.30%	1.40%	1.50%	1.50%	1.60%	1.70%	1.80%	1.90%	2.00%
6 Month LIBID	0.90%	1.00%	1.20%	1.30%	1.40%	1.50%	1.60%	1.70%	1.70%	1.80%	1.90%	2.00%	2.10%	2.20%
12 Month LIBID	1.10%	1.20%	1.30%	1.40%	1.50%	1.60%	1.70%	1.80%	1.90%	2.00%	2.10%	2.20%	2.30%	2.40%
5yr PWLB Rate	2.00%	2.10%	2.20%	2.20%	2.30%	2.30%	2.40%	2.50%	2.50%	2.60%	2.60%	2.70%	2.80%	2.80%
10yr PWLB Rate	2.50%	2.50%	2.60%	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%
25yr PWLB Rate	2.90%	2.90%	3.00%	3.10%	3.10%	3.20%	3.30%	3.30%	3.40%	3.40%	3.50%	3.50%	3.60%	3.60%
50yr PWLB Rate	2.70%	2.70%	2.80%	2.90%	2.90%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.30%	3.40%	3.40%

The interest rate forecasts provided by Link Asset Services above, are predicated on an assumption of an agreement being reached on Brexit between the UK and the EU. In the event of an orderly non-agreement exit, it is likely that the Bank of England would take action to cut Bank Rate from 0.75% in order to help economic growth deal with the adverse effects of this situation. This is also likely to cause short to medium term gilt yields to fall. If there was a disorderly Brexit, then any cut in Bank Rate would be likely to last for a longer period and also depress short and medium gilt yields correspondingly. It is also possible that the government could act to protect economic growth by implementing fiscal stimulus.

The balance of risks to the UK

- The overall balance of risks to economic growth in the UK is probably neutral.
- The balance of risks to increases in Bank Rate and shorter term PWLB rates, are probably also even and are broadly dependent on how strong GDP growth turns out, how slowly inflation pressures subside, and how quickly the Brexit negotiations move forward positively.

One risk that is both an upside and downside risk, is that all central banks are now working in very different economic conditions than before the 2008 financial crash as there has been a major increase in consumer and other debt due to the exceptionally low levels of borrowing rates that have prevailed for ten years since 2008. This means that the neutral rate of interest in an economy, (i.e. the rate that is neither expansionary nor deflationary), is difficult to determine definitively in this new environment, although central banks have made statements that they expect it to be much lower than before 2008. Central banks could therefore either over or under do increases in central interest rates.

Downside risks to current forecasts for UK gilt yields and PWLB rates currently include:

- **Brexit** – if it were to cause significant economic disruption and a major downturn in the rate of growth.

- **Bank of England monetary policy** takes action too quickly, or too far, over the next three years to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than we currently anticipate.
- A resurgence of the **Eurozone sovereign debt crisis**, possibly in **Italy**, due to its high level of government debt, low rate of economic growth and vulnerable banking system, and due to the election in March of a government which has made a lot of anti-austerity noise. At the time of writing, the EU has rejected the proposed Italian budget and has demanded cuts in government spending which the Italian government has refused. The rating agencies have started on downgrading Italian debt to one notch above junk level. If Italian debt were to fall below investment grade, many investors would be unable to hold it. Unsurprisingly, investors are becoming increasingly concerned by the actions of the Italian government and consequently, Italian bond yields have risen sharply – at a time when the government faces having to refinance large amounts of debt maturing in 2019.
- Weak capitalisation of some **European banks**. Italian banks are particularly vulnerable; one factor is that they hold a high level of Italian government debt - debt which is falling in value. This is therefore undermining their capital ratios and raises the question of whether they will need to raise fresh capital to plug the gap.
- **German minority government**. In the German general election of September 2017, Angela Merkel's CDU party was left in a vulnerable minority position dependent on the fractious support of the SPD party, as a result of the rise in popularity of the anti-immigration AfD party. Then in October 2018, the results of the Bavarian and Hesse state elections radically undermined the SPD party and showed a sharp fall in support for the CDU. As a result, the SPD is reviewing whether it can continue to support a coalition that is so damaging to its electoral popularity. After the result of the Hesse state election, Angela Merkel announced that she would not stand for re-election as CDU party leader at her party's convention in December 2018. However, this makes little practical difference as she is still expected to aim to continue for now as the Chancellor. However, there are five more state elections coming up in 2019 and EU parliamentary elections in May/June; these could result in a further loss of electoral support for both the CDU and SPD which could also undermine her leadership.
- **Other minority eurozone governments**. Spain, Portugal, Netherlands and Belgium all have vulnerable minority governments dependent on coalitions which could prove fragile. Sweden is also struggling to form a government due to the anti-immigration party holding the balance of power, and which no other party is willing to form a coalition with.
- **Austria, the Czech Republic and Hungary** now form a strongly anti-immigration bloc within the EU while **Italy**, this year, has also elected a strongly anti-immigration government. Elections to the EU parliament are due in May/June 2019.
- Further increases in interest rates in the US could spark a **sudden flight of investment funds** from more risky assets e.g. shares, into bonds yielding a much improved yield. In October 2018, we have seen a sharp fall in equity markets but this has been limited, as yet. Emerging countries which have borrowed heavily in dollar denominated debt, could be particularly exposed to this risk of an investor flight to safe havens e.g. UK gilts.
- There are concerns around the level of **US corporate debt** which has swollen massively during the period of low borrowing rates in order to finance mergers and acquisitions. This has resulted in the debt of many large corporations being downgraded to a BBB credit rating, close to junk status. Indeed, 48% of total investment grade corporate debt is now rated at BBB. If such corporations fail to generate profits and cash flow to reduce their debt levels as expected, this could tip their debt into junk ratings which will increase their cost of financing and further negatively impact profits and cash flow.
- **Geopolitical risks**, especially North Korea, but also in Europe and the Middle East, which could lead to increasing safe haven flows.

Upside risks to current forecasts for UK gilt yields and PWLB rates

- **Brexit** – if both sides were to agree a compromise that removed all threats of economic and political disruption.

- **The Fed causing a sudden shock in financial markets** through misjudging the pace and strength of increases in its Fed. Funds Rate and in the pace and strength of reversal of QE, which then leads to a fundamental reassessment by investors of the relative risks of holding bonds, as opposed to equities. This could lead to a major flight from bonds to equities and a sharp increase in bond yields in the US, which could then spill over into impacting bond yields around the world.
- The **Bank of England is too slow** in its pace and strength of increases in Bank Rate and, therefore, allows inflation pressures to build up too strongly within the UK economy, which then necessitates a later rapid series of increases in Bank Rate faster than we currently expect.
- **UK inflation**, whether domestically generated or imported, returning to sustained significantly higher levels causing an increase in the inflation premium inherent to gilt yields.

Brexit timetable and process at 13.12.18

- March 2017: UK government notified the European PCC of its intention to leave under the Treaty on European Union Article 50 on 29 March 2019.
- 25.11.18 EU27 leaders endorsed the withdrawal agreement
- 11.12.18 vote in UK Parliament on the agreement (postponed)
- 21.12.18 – 6.1.19 UK Parliamentary recess
- Before 21.1.19 vote in UK Parliament on the agreement
- 8.1.19 – 29.3.19 second vote (?) in UK parliament if first vote rejects the deal
- 21.1.19 vote in Parliament on a 'no deal' scenario; if approved...
- By 29.3.19 then ratification by EU Parliament requires a simple majority
- By 29.3.19 if UK and EU parliaments agree the deal, EU PCC needs to approve the deal; 20 countries representing 65% of the EU population must agree
- 29.3.19 UK leaves the EU (or asks the EU for agreement to an extension of the Article 50 period if UK Parliament rejects the deal and no deal departure?)
- 29.3.19: if an agreement is reached with the EU on the terms of Brexit, then this will be followed by a proposed **transitional period ending around December 2020**.
- UK continues as a full EU member until March 2019 with access to the single market and tariff free trade between the EU and UK. Different sectors of the UK economy may leave the single market and tariff free trade at different times during the transitional period.
- The UK and EU would attempt to negotiate, among other agreements, a bi-lateral trade agreement over that period.
- The UK would aim for a negotiated agreed withdrawal from the EU, although the UK could also exit without any such agreements in the event of a breakdown of negotiations.
- If the UK exits without an agreed deal with the EU, World Trade Organisation rules and tariffs could apply to trade between the UK and EU - but this is not certain.
- On full exit from the EU: the UK parliament would repeal the 1972 European Communities Act.

4. Investment Strategy 2019/20

- 4.1 The Bank Rate is forecast to stay flat at 0.75% until quarter 2 2019 and not to rise above 1.25% until quarter 4 2020. Bank Rate forecasts for financial year ends (March) are:

- 2018/19 0.75%
- 2019/20 1.25%
- 2020/21 1.50%
- 2021/22 2.00%

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
2018/19	0.75%
2019/20	1.00%
2020/21	1.50%
2021/22	1.75%
2022/23	1.75%
2023/24	2.00%
Later Years	2.50%

4.3 There are 3 key considerations to the treasury management investment process. CLG'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.

4.4 CLG'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.

4.5 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 (Section 5).
- Details of Specified and Non-Specified investment types (Section 6).

5. Investment Strategy 2019/20 - 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

- (i) **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

- (ii) **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 Banks	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, Parish 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 2019/20 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 relies 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 2019/20 to reflect the level of cash balances and to avoid large deposits with the DMO.
- 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 2019/20 – 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. Institutions of “high” credit quality are deemed to be Specified Investments. From the pool of high quality investment counterparties identified in Section 5, the following are deemed to be Specified Investments where the period of deposit is 365 days or less:
- 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, Parish 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 greater than 365 days.
- 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 2019/20 therefore includes both Specified and Non-Specified Investment institutions.

7. Borrowing Strategy 2019/20

- 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 add to the PCC's borrowing requirement. The PCC's need to borrow is measured by the Capital Financial Requirement, 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 The main source of long term loans is 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.
- 7.4 External borrowing currently stands at £8.2m (excluding PFI). At 31 March 2018 there was a £11.8m Capital Financing Requirement (CFR) relating to unfunded capital expenditure which had been financed from internal resources. The CFR is estimated to be £13.6m at 31 March 2019, £15.1m at 31 March 2020 and £15.4 at 31 March 2021. Additional long term borrowing is estimated at £2.6m for 2018/19, £2.0m for 2019/20 and £0.5m for 2020/21. 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 Section 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, taking into account 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 31.3.19:

	Actual*	Lower Limit	Upper Limit
Under 12 months	4.2%	0%	15%
12 months and within 24 months	4.4%	0%	15%
24 months and within 5 years	14.4%	0%	45%
5 years and within 10 years	28.7%	0%	75%
10 years and above	48.3%	0%	100%

* Actual is based on existing balances at 31.12.18

- **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 2019/20, the maximum level of PCC funds invested for periods greater than 365 days will be no more than £3.5m.

9. Prudential Code Indicators 2019/20, 2020/21, 2021/22

Background

9.1 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 is to applied from 2018/19

9.2 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.

9.3 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)

9.4 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.

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

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

10. The Indicators

10.1 The **Capital Expenditure Payment Forecast** is detailed in Appendix D. The total estimated payments are:

	2019/20	2020/21	2021/22
	£m	£m	£m
Capital Expenditure Forecast	6.563	4.126	2.317

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.

10.2 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

2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
2.53%	2.53%	2.50%

- 10.3 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 a capital purpose, 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			
31/03/19 Estimate	31/03/20 Estimate	31/03/21 Estimate	31/03/22 Estimate
£36.750m	£37.808m	£37.693m	£36.908m

- 10.4 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.”

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

- 10.5 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 2019/2020 and future years limits.

For 2019/20 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			
	2019/20	2020/21	2021/22
	£m	£m	£m
PWLB borrowing	12.128	12.237	11.827
Other long term liabilities (PIC PFI)	22.721	22.302	21.846
Headroom	4.849	5.039	5.080
Total	39.698	39.578	38.753

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

- 10.6 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 external debt limit without the additional headroom. The

operational boundary represents a key management tool for in year monitoring.

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			
	2019/20	2020/21	2021/22
	£m	£m	£m
PWLB borrowing	12.128	12.237	11.827
Other long term liabilities (PIC PFI)	22.721	22.302	21.846
Total	34.849	34.539	33.673