APPENDIX A

OFFICE OF THE POLICE AND CRIME COMMISSIONER FOR GWENT

Treasury Management Strategy 2018/19 to 2020/21

1 INTRODUCTION

1.1 Treasury Management is the management of cash flows, banking, money market and capital market transactions; the management of the associated risks, and the pursuit of the optimum performance or return consistent with those risks. The treasury management service is an important part of the overall financial management of the Commissioner's affairs. The Commissioner 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 Commissioner'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 Commissioner's capital plans. These capital plans provide a guide to the borrowing need of the Commissioner, essentially the longer term cash flow planning to ensure that the Commissioner 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, any debt previously drawn may be restructured to meet the Commissioner's risk or cost objectives.

1.2 The Commissioner's treasury activities are strictly regulated by statutory requirements and a professional code of practice, the CIPFA Code of Practice on Treasury Management. Under the Code, the Commissioner is required to receive and approve, as a minimum, three main reports each year, which incorporate a variety of policies, estimates and actuals.

1.3 CIPFA is currently conducting a review of the Treasury Management Code of Practice and the Prudential Code. This review will particularly focus on non-treasury investments and especially on the purchase of property with a view to generating income. (This is particularly relevant to English councils under the Localism Act which does not apply in Wales.) Such purchases could involve undertaking external borrowing to raise the cash to finance these purchases, or the use of existing cash balances. Both actions would affect treasury management.

1.4 The revised Prudential Code is expected to be issued in December 2017, consequently this strategy document has been drafted using the guidance contained within the current code. CIPFA have indicated that the revised code will withdraw a number of indicators including the incremental impact of capital investment decisions on council tax; estimates of the ratio of financing costs as a percentage of net revenue for three years ahead; and actual ratio of financing costs to net revenue. These have been maintained within this report.

1.5 The adoption of a Treasury Management Strategy for 2018/19, prior to the start of the financial year, is the first of the three reporting requirements in respect of that year. This will be followed in due course by a mid-year Treasury Management report and an Annual Treasury Report before 30th September 2018, providing a selection of actual prudential and treasury indicators.

1.6 The Treasury Management Strategy for 2018/19 covers two main areas:

Capital Issues

(i) The capital plans and the prudential indicators; and
(ii) The Minimum Revenue Provision (MRP) strategy.

Treasury Management Issues

(i) Debt and investment projections;
(ii) Limits on borrowing activity;
(iii) The expected movement in interest rates;
(iv) Borrowing and investment strategies;
(v) Treasury performance indicators; and
(vi) Specific limits on treasury activities.

2. CAPITAL PRUDENTIAL INDICATORS 2018/19 to 2020/21

2.1 The Local Government Act 2003 requires the Commissioner to adopt the CIPFA Prudential Code and produce prudential indicators. Each indicator either summarises the expected capital activity or introduces limits upon that activity, and reflects the outcome of the underlying capital appraisal systems. This document updates currently approved indicators and introduces new indicators for 2020/21.

2.2 Within this overall prudential framework there is an impact on the Commissioner's treasury management activity, as it will directly impact on borrowing or investment activity.

2.3 Capital Expenditure Plans

2.3.1 The capital expenditure plans are summarised below and this forms the first of the prudential indicators. A certain level of capital expenditure is grant supported by the Government; any decisions by the Commissioner to spend above this level will be considered unsupported capital expenditure.

2.3.2 This unsupported capital expenditure needs to have regard to:

(i) Service objectives (e.g. strategic planning);

(ii) Stewardship of assets (e.g. asset management planning);
(iii) Value for money (e.g. option appraisal);
(iv) Prudence and sustainability (e.g. implications for external borrowing and whole life costing);
(v) Affordability (e.g. implications for the council tax); and
(vi) Practicality (e.g. the achievability of longer term plans).

2.3.3 The revenue consequences of capital expenditure, particularly the supported capital expenditure, will need to be paid for from the Commissioner's own resources.

2.3.4 This capital expenditure can be paid for immediately (by applying capital resources such as capital receipts, capital grants, earmarked reserves or revenue resources), but if these resources are insufficient any residual capital expenditure will add to the Commissioner's borrowing need.

2.3.5 A key risk to the plans, are that the level of Government support has been estimated and could therefore be subject to change.

2.3.6 The Commissioner is asked to approve the following summary capital expenditure projections which is the first prudential indicator:

First Prudential Indicator - Estimates of Capital Expenditure					
	2017/18 Original £000's	2017/18 Revised £000's	2018/19 Estimate £000's	2019/20 Estimate £000's	2020/21 Estimate £000's
Capital Expenditure	**7,162**	**7,361**	**23,269**	**14,098**	**5,955**
Financed by:					
Capital Receipts	0	0	0	600	500
Capital Grants and PIF Grants	526	449	449	449	449
Reserves	6,138	6,337	22,245	5,991	0
Revenue	498	575	575	575	575
Net Financing Need for the Year	**0**	**0**	**0**	**6,483**	**4,431**

2.3.7 The above financing need excludes other long term liabilities, such as Private Finance Initiative (PFI) and leasing arrangements which already include borrowing instruments.

2.4 The Commissioner's Borrowing Need (the Capital Financing Requirement)

2.4.1 The second prudential indicator is the Commissioner's Capital Financing Requirement (CFR) which is simply the total outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is a measure of the Commissioner's underlying borrowing need. Any capital expenditure in the table in paragraph 2.3.6 above which has not immediately been paid for will increase the CFR.

2.4.2 Following accounting changes, the CFR now includes any other long term liabilities (e.g. PFI schemes) brought onto the balance sheet. Whilst this increases the CFR, and therefore the Commissioner's borrowing requirement, these types of scheme include a borrowing facility and so the Commissioner is not required to borrow separately for this scheme. As at 31 March 2017 the Commissioner had £4.75m of such schemes within the CFR.

2.4.3 The Commissioner is asked to approve the CFR projections below:

Second Prudential Indicator - the Capital Financing Requirement (CFR)					
	2017/18 Original £000's	2017/18 Estimate £000's	2018/19 Estimate £000's	2019/20 Estimate £000's	2020/21 Estimate £000's
Opening CFR		4,750	4,684	0	6,483
Capital Spend		7,361	23,269	14,098	5,955
Movement in finance lease liability		(66)	(4,684)	0	0
Resources Used		(7,361)	(23,269)	(7,615)	(1,524)
MRP		0	0	0	(162)
Closing CFR		**4,684**	**0**	**6,483**	**10,752**

2.4.4 The CFR projections above assume the early repayment of the Commissioner's PFI in 2018/19. Although the Commissioner will not be required to make a MRP until 2020/21, he will still require a policy on this matter as per section 3 below.

3. MINIMUM REVENUE PROVISION POLICY

3.1 The Commissioner is required to recognise an element of outstanding capital borrowing each year through a revenue charge known as the MRP. The MRP is calculated to match the repayment of borrowing over the life of the assets, for which debt has been raised. It is also permissible to pay an additional amount known as a Voluntary Revenue Provision (VRP). Under Welsh Government (WG) Regulations the Commissioner has to approve an MRP Statement in advance of each year. The Commissioner is recommended to adopt the following MRP policy for 2018/19:

(i) For all capital expenditure incurred before 1st April 2008 and all supported capital expenditure incurred since that date or in the future, the MRP policy will be 4% of the CFR. This is consistent with the practice in place prior to the current regulations; and

(ii) For all unsupported borrowing since 1st April 2008 and in the future, the asset life method will be used, i.e., the amount borrowed will be divided by the life of the asset.

4. THE USE OF THE COMMISSIONER'S RESOURCES AND INVESTMENT POSITION

4.1 The application of resources (capital receipts, reserves etc.) will have an on-going impact on investments. Detailed below are estimates of the year-end balances for each resource and anticipated day to day cash flow balances.

Investment Position - Year end Resources					
	2017/18 Original £000's	2017/18 Revised £000's	2018/19 Estimate £000's	2019/20 Estimate £000's	2020/21 Estimate £000's
Police Fund	8,379	12,905	9,000	9,000	9,000
Earmarked Reserves	33,403	35,635	15,358	3,941	3,941
Provisions	1,529	1,585	1,585	1,585	1,585
Total Core Funds	43,311	50,125	25,943	14,526	14,526
Working Capital	4,477	6,773	6,773	6,773	6,773
Expected Investments	47,788	56,898	32,716	21,299	21,299

*Working capital balances shown are estimated year end; these may be higher mid-year.

5. AFFORDABILITY PRUDENTIAL INDICATORS

5.1 The previous sections cover the overall capital and control of borrowing prudential indicators. Prudential indicators are also required to assess the affordability of the capital investment plans. The Commissioner is asked to approve the third and fourth prudential indicators, which assess affordability in terms of the impact of the capital investment plans on the Commissioner's overall finances.

5.2 The third prudential indicator is the ratio of net financing costs (financing income less finance interest expense) to net revenue stream. This indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream.

Third Prudential Indicator - Ratio of Financing Costs to Net Revenue Stream					
	2017/18 Estimate %	2017/18 Revised %	2018/19 Estimate %	2019/20 Estimate %	2020/21 Estimate %
Ratio	**-0.16%**	**-0.23%**	**-0.18%**	**0.05%**	**0.33%**

5.3 The estimates of financing costs include current commitments and the proposals in the budget report. The ratio turns positive in 2019/20 as interest expense will be payable on newly borrowed debt, at this point forecast interest expense will be greater than interest income.

5.4 The fourth prudential indicator identifies the increased revenue costs associated with the approved three year capital programme and expresses these in terms of the increase in Band D council tax. The assumptions are based on the budget, but will invariably include some estimates, such as the level of Government support, which is not published over a three year period.

	2018/19 Estimate £	2019/20 Estimate £	2020/21 Estimate £
Ratio	**0.51**	**1.05**	**2.25**

6. BORROWING

6.1 The capital expenditure plans are set out in Section 2.3.6. The treasury management function ensures that the cash is organised in accordance with the relevant professional codes, so that sufficient cash is available to meet the capital expenditure requirements. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of approporiate borrowing facilities. The strategy covers the relevant treasury prudential indicators, the current and projected debt positions and the annual investment strategy.

6.2 **Current portfolio position**

The treasury portfolio position at 1st April 2017, with forward projections, are summarised below. The table shows the actual external debt (the treasury management operations), against the underlying capital borrowing need (the CFR), highlighting any over or under borrowing.

Borrowing Position					
	2017/18 Original £000's	2017/18 Revised £000's	2018/19 Estimate £000's	2019/20 Estimate £000's	2020/21 Estimate £000's
External Debt					
Debt at 1st April		0	0	0	6,483
Expected Change in Debt		0	0	6,483	4,431
Other Long Term Liabilities (Finance Lease Liability - PFI) at 1st April	4,752	4,750	4,684	0	0
Expected Change in OLTL	(66)	(66)	(4,684)	0	0
Gross Debt at 31st March	**4,686**	**4,684**	**0**	**6,483**	**10,914**
Capital Financing Requirement at 31	4,686	4,684	0	6,483	10,752
Under/(Over) Borrowing	**0**	**0**	**0**	**0**	**(162)**

6.3 The related impact of the above movements on the revenue budget is shown below:

Impact on Revenue Budgets					
	2017/18 Estimate £000's	2017/18 Revised £000's	2018/19 Estimate £000's	2019/20 Estimate £000's	2020/21 Estimate £000's
Revenue Budget Heading					
Interest on Borrowing	0	0	0	201	338
Investment Income	(198)	(284)	(224)	(135)	(106)
Net Police Fund Borrowing Cost	**(198)**	**(284)**	**(224)**	**66**	**232**

7. LIMITS ON BORROWING ACTIVITY

7.1 Within the prudential indicators there are a number of key indicators to ensure that the Commissioner operates activities within well-defined limits. For the first of these the Commissioner needs to ensure that gross debt does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2018/19 and the following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes. The following table is relevant for this indicator.

Limits on Borrowing Activity - Year End Position					
	2017/18 Estimate £000's	2017/18 Revised £000's	2018/19 Estimate £000's	2019/20 Estimate £000's	2020/21 Estimate £000's
Gross Debt	4,686	4,684	0	6,483	10,914
Investments	(47,788)	(56,898)	(32,716)	(21,299)	(21,299)
Net Borrowing	(43,102)	(52,214)	(32,716)	(14,816)	(10,385)
Capital Financing Requirement	4,686	4,684	0	6,483	10,752
Gross Debt <= CFR	Yes	Yes	Yes	Yes	No

7.2 The next key indicator is the operational boundary. This is the limit beyond which external debt is not normally expected to exceed.

Operational Boundary for Debt at 1st April					
	2017/18 Estimate £000's	2017/18 Revised £000's	2018/19 Estimate £000's	2019/20 Estimate £000's	2020/21 Estimate £000's
Debt	0	0	6,000	12,000	16,000
Other Long Term Liabilities	4,752	4,750	4,684	0	0
Net Borrowing	4,752	4,750	10,684	12,000	16,000

7.3 A further key prudential indicator representing a control on the overall level of borrowing is the Authorised Limit for External Debt. This is calculated on a 5% mark up on the operational boundary. This represents a limit beyond which external debt is prohibited, and this limit needs to be set or revised by the Commissioner. It reflects the level of external debt which, while not desired, could be afforded in the short term, but is not sustainable in the longer term. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003. The Government retains an option to control either the total plans of all Local Authorities and Commissioners, or those of a specific Authority or Commissioner, although no control has yet been exercised. The Commissioner is asked to approve the following Authorised Limit:

Authorised Limit for Debt at 1st April					
	2017/18 Estimate £000's	2017/18 Revised £000's	2018/19 Estimate £000's	2019/20 Estimate £000's	2020/21 Estimate £000's
Debt	0	0	6,300	12,600	16,800
Other Long Term Liabilities	4,752	4,750	4,684	0	0
Working Capital Requirement	4,477	6,773	6,773	6,773	6,773
Authorised Limit	9,229	11,523	17,757	19,373	23,573

7.4 Risks associated with any advance borrowing activity will be subject to appraisal in advance and subsequent reporting through the mid-year or annual reporting mechanism.

8. PROSPECTS FOR INTEREST RATES

8.1 The Commissioner uses Link Asset Services (previously known as Capita Asset Services) as treasury management advisors and part of their service is to provide a view on the prospects for interest rates and economic growth. The following table gives the Link Asset Services central view on the prospects for interest rates.

	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
Bank Rate	0.50%	0.50%	0.50%	0.50%	0.75%	0.75%	0.75%	0.75%	1.00%	1.00%	1.00%	1.25%	1.25%	1.25%
5yr PWLB Rate	1.50%	1.60%	1.60%	1.70%	1.80%	1.80%	1.90%	1.90%	2.00%	2.10%	2.10%	2.20%	2.30%	2.30%
10yr PWLB View	2.10%	2.20%	2.30%	2.40%	2.40%	2.50%	2.60%	2.60%	2.70%	2.70%	2.80%	2.90%	2.90%	3.00%
25yr PWLB View	2.80%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.40%	3.50%	3.50%	3.60%	3.60%
50yr PWLB Rate	2.50%	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.20%	3.30%	3.30%	3.40%	3.40%

8.2 As expected, the Monetary Policy Committee (MPC) delivered a 0.25% increase in Bank Rate at its meeting on 2 November. This removed the emergency cut in August 2016 after the EU referendum. The MPC also gave forward guidance that they expected to increase Bank rate only twice more by 0.25% by 2020 to end at 1.00%. The Link Asset Services forecast as above includes increases in Bank Rate of 0.25% in November 2018, November 2019 and August 2020.

8.3 Economic and interest rate forecasting remains difficult with so many external influences weighing on the UK. The above forecasts (and MPC decisions) will be liable to further amendment depending on how economic data and developments in financial markets transpire over the next year. Geopolitical developments, especially in the EU, could also have a major impact. Forecasts for average investment earnings beyond the three-year time horizon will be heavily dependent on economic and political developments.

8.4 The overall longer run trend is for gilt yields and PWLB rates to rise, albeit gently. It has long been expected, that at some point, there would be a more protracted move from bonds to equities after a historic long-term trend, over about the last 25 years, of falling bond yields. The action of central banks since the financial crash of 2008, in implementing substantial Quantitative Easing, added further impetus to this downward trend in bond yields and rising bond prices. The sharp rise in bond yields since the US Presidential election in November 2016 has called into question whether the previous trend may go into reverse, especially now the Fed. has taken the lead in reversing monetary policy by starting, in October 2017, a policy of not fully reinvesting proceeds from bonds that it holds when they mature.

8.5 The overall balance of risks to economic recovery in the UK is probably to the downside, particularly with the current level of uncertainty over the final terms of Brexit.

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

- Bank of England monetary policy takes action too quickly 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.
- Geopolitical risks, especially North Korea, but also in Europe and the Middle East, which could lead to increasing safe haven flows.
- A resurgence of the Eurozone sovereign debt crisis, possibly Italy, due to its high level of government debt, low rate of economic growth and vulnerable banking system.
- Weak capitalisation of some European banks.
- The result of the October 2017 Austrian general election is likely to result in a strongly anti-immigrant coalition government. In addition, the new Czech prime minister is expected to be Andrej Babis who is strongly against EU migrant quotas and refugee policies. Both developments could provide major impetus to other, particularly former Communist bloc countries, to coalesce to create a major block to progress on EU integration and centralisation of EU policy. This, in turn, could spill over into impacting the Euro, EU financial policy and financial markets.
- Rising protectionism under President Trump
- A sharp Chinese downturn and its impact on emerging market countries

8.7 The potential for upside risks to current forecasts for UK gilt yields and PWLB rates, especially for longer term PWLB rates include: -

- 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 returning to sustained significantly higher levels causing an increase in the inflation premium inherent to gilt yields.
- 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 Quantitative Easing, 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.

9. BORROWING STRATEGY 2018/19 – 2020/21

9.1 The uncertainty over future interest rates increases the risks associated with treasury activity. Investment returns are likely to remain low during 2018/19 but to be on a gently rising trend over the next few years.As a result the Commissioner will continue a cautious approach to treasury strategy.

9.2 The Chief Finance Officer (CFO) (Section 151 Officer), 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 shown in the forecast above. It is likely that shorter term fixed rates may provide lower cost opportunities in the short/medium term.

9.3 The Commissioner is currently maintaining a neutral-borrowing position. This means that the capital borrowing need (the Capital Financing Requirement), has been fully matched with loan debt. For 2018/19 this debt represents the finance lease liability linked to the PFI asset. The Commissioner plans to settle this liability in 2018/19 and the costs of such a strategy have been included in the Capital Programme.

9.4 The Commissioner will not have any further CFR in 2018/19 as earmarked reserves will be utilised to fund the Capital Programme.

9.5 External debt will only be sought once the reserves earmarked for capital expenditure have been utilised. The Commissioner anticipates that external borrowing will be required from 2019/20. During 2019/20 the Commissioner plans to continue to adopt a neutral borrowing position and will be slightly over-borrowed for 2020/21. The over-borrowing position is a direct impact of the MRP charge reducing the CFR.

10. INVESTMENT STRATEGY 2018/19 – 2020/21

10.1 **Key Objectives -** The Commissioner's primary investment strategy objectives are, firstly, safeguarding the re-payment of the principal and interest of his investments on time and, secondly, ensuring adequate liquidity. The investment return is an important third objective, but not as important as the first two objectives. Following the economic background outlined above, the current investment climate has one over-riding risk consideration; that of counterparty security risk.

10.2 **Risk Benchmarking** – A development in the revised 2011 Codes and the Welsh Government Investment Guidance is the consideration and approval of security and liquidity benchmarks. Yield benchmarks are currently widely used to assess investment performance. Discrete security and liquidity benchmarks are new requirements in the revised Code, although the application of these is more subjective in nature.

10.3 These benchmarks are simple guides (not limits) and so may be breached from time to time, depending on movements in interest rates and counterparty criteria. The purpose of the benchmark is that officers will monitor the current and trend position and amend the operational strategy to manage risk as conditions change. Any breach of the benchmarks will be reported, with supporting reasons in the Mid-Year or Annual Report.

10.4 Security - The Commissioner's maximum security risk benchmark for the current portfolio, when compared to these historic default tables, is:

(i) 0.009% historic risk of default when compared to the whole portfolio**.**

10.5 Liquidity – In respect of this area the Commissioner seeks to maintain:

(i) Liquid short term deposits of at least £2m available with a week's notice; and
(ii) Weighted Average Life of investments with banks between 3 and 12 months; and
(iii) Note that no overdraft facility is held at Lloyds bank.

10.6 Yield - Local measures of yield benchmarks are:

(i) Investments – Internal returns compared to the 7 day London Interbank Bid Rate (LIBID).

10.7 The security benchmark for each individual year is:

	1 year	2 years	3 years	4 years	5 years
Maximum	0.009%	Not applicable	Not applicable	Not Applicable	Not Applicable

Note: This benchmark is an average risk of default measure, and would not constitute an expectation of loss against a particular investment.

10.8 **Investment Counterparty Selection Criteria -** The primary principle governing the Commissioner's investment criteria is the security of his investments, although the yield or return on the investment is also a key consideration. The Commissioner will not use non-specified investments i.e. investments exceeding 1 year 364 days. The Commissioner will ensure:

(i) A policy covering types of investment, criteria for choosing investment counterparties with adequate security, and monitoring their security. This is set out in the Specified Investment (investments not exceeding 1 year 364 days) sections below; and

(ii) Sufficient liquidity in investments. For this purpose procedures will be set out for determining the maximum periods for which funds may prudently be committed. These procedures also apply to the prudential indicators covering the maximum principal sums invested.

10.9 The Assistant Chief Officer - Resources will maintain a counterparty list in compliance with the following criteria. This criteria is separate from that which chooses Specified and Non-Specified Investments as it provides an overall pool of counterparties considered high quality the Commissioner may use rather than defining what his investments are.

10.10 The rating criteria use the lowest common denominator method of selecting counterparties and applying limits. This means that the application of the Commissioner's minimum criteria will apply to the lowest available rating for any institution. For instance if an institution is rated by two agencies, one meets the Commissioner's criteria, the other does not, the institution will fall outside the lending criteria. This is in compliance with a CIPFA Treasury Management Panel recommendation in March 2009 and the CIPFA Treasury Management Code of Practice.

10.11 Credit rating information is supplied by our treasury consultants on all active counterparties that comply with the criteria below. Any counterparty failing to meet the criteria would be omitted from the counterparty (dealing) list. Any rating changes, rating watches (notification of a likely change), rating outlooks (notification of a possible longer term change) are provided to officers almost immediately after they occur and this information is considered before dealing. For instance a negative rating watch applying to a counterparty at the minimum of the Commissioner's criteria will be suspended from use, with all others being reviewed in light of market conditions.

10.12 The Commissioner only uses the following high credit quality counterparties:

(i) UK banks and banks domiciled in a country other than the UK which has a minimum Sovereign long term rating of AAA, which have at least the following Fitch, Moody's and Standard and Poor's ratings (where rated):

- Short Term – F1/A1/P1;
- Long Term – A;

(ii) Part nationalised UK banks – Lloyds Banking Group and Royal Bank of Scotland. These banks can be included if they continue to be part nationalised or they meet the ratings in Banks above;

(iii) Building Societies which:

- Meet the ratings for banks outlined above; or
- Have assets in excess of £1bn;

(iv) Money Market Funds – AAA;
(v) UK Government (including gilts and the DMADF (see below));
(vi) Local Authorities; and
(vii) Supranational institutions.

10.13 Due care will be taken to consider the country, group and sector exposure of the Commissioner's investments. In part, the country selection will be chosen by the credit rating of the Sovereign state. In addition:

(i) No more than £3m will be placed with any single non-UK country at any time;
(ii) Limits in place above will apply to Group companies; and
(iii) Sector limits will be monitored regularly for appropriateness.

10.14 Additional requirements under the Code of Practice now require the Commissioner 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 officers to use, additional operational market information will be applied before making any specific investment decision from the agreed pool of counterparties. This additional market information (for example Credit Default Swaps, negative rating watches/outlooks) will be applied to compare the relative security of differing investment counterparties.

10.15 The time and monetary limits for institutions on the Commissioner's Counterparty List are as follows:

	Fitch (or equivalent)	Money Limit	Time Limit
UK Banks (Groups)	*P1/F1/A1*	£10m	<365days
Non UK Banks (Groups)	*P1/F1/A1*	£5m	<365days
Building Societies	*P1/F1/A1*	£5m	<365days
Money Market Funds	AAA	£5m	<365days
Local Authorities	-	£10m	<2 years
UK DMO	-	None	<365days
Guaranteed Organisations	-	£3m*	<365days

**Guaranteed institutions will need to be restricted to the terms of the guarantee.*

10.16 In the normal course of the Commissioner's cash flow operations it is expected that only Specified Investments will be utilised.

10.17 The criteria for choosing counterparties set out above provide a sound approach to investment in 'normal' market circumstances. However, under exceptional market conditions the CFO may, after consulting the Commissioner, temporarily restrict further investment activity to those counterparties considered of higher credit quality than the minimum criteria set out for approval. These restrictions will remain in place until the banking system returns to 'normal' conditions. Similarly the time periods for investments may be restricted. Examples of these restrictions would be the greater use of the Debt Management Account Deposit Facility (DMADF – a Government body which accepts local authority deposits), Money Market Funds, guaranteed deposit facilities and strongly rated institutions offered support by the UK Government. The credit criteria have been amended to reflect these facilities.

10.18 Additionally, the Commissioner reserves the right to continue to hold an investment if the institutions credit rating is down-graded during the investment period if he is satisfied that the risks associated with the institution and investment are able to be managed and/or mitigated appropriately.

10.19 Banking Arrangements

The Commissioner's banker is Lloyds Bank, having switched from the Co-operative Bank during 2014/15. The contract with Lloyds expires on 30 July 2018 with an option to extend for 12 months.

11. SENSITIVITY TO INTEREST RATE MOVEMENTS

11.1 The Commissioner is required to disclose in the accounts the impact of risks on treasury management activity. Whilst most of the risks facing the treasury management service are addressed elsewhere in this report (credit risk, liquidity risk, market risk, maturity profile risk), the impact of interest rate risk is discussed but not quantified. The table below highlights the estimated impact of a 1% increase/decrease in all interest rates to the estimated treasury management costs/income for next year. That element of the debt and investment portfolios which are of a longer term, fixed interest rate nature will not be affected by interest rate changes.

Sensitivity to Interest Rate Movements		
	2018/19 Estimated +1% £000's	2018/19 Estimated -1% £000's
Interest on Borrowing	0	0
Investment Income	448	(224)

12. TREASURY MANAGEMENT - LIMITS ON ACTIVITY

12.1 There are four further treasury activity limits, which were previously prudential indicators. The purpose of these is to contain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of an adverse movement in interest rates. The Commissioner approves these limits.

	2018/19	**2019/20**	**2020/21**
Interest rate Exposures			
	Upper	**Upper**	**Upper**
Limits on fixed interest rates based on net debt	100%	100%	100%
Limits on variable interest rates based on net debt	35%	35%	35%
Maturity Structure of fixed interest rate borrowing 2018/19			
		Lower	**Upper**
Under 12 months		0%	20%
12 months to 2 years		0%	20%
2 years to 5 years		0%	20%
5 years to 10 years		0%	20%
10 years and above		20%	90%
Maximum principal sums invested > 364 days			
Principal sums invested > 364 days	£m 10	£m 10	£m 10

13. PERFORMANCE INDICATORS

13.1 The Code of Practice on Treasury Management requires the Commissioner to set performance indicators to assess the adequacy of the treasury function over the year. These are distinct historic indicators, as opposed to the prudential indicators, which are predominantly forward looking. Performance indicators to be used for the treasury function are:

(i) Debt – Borrowing - Average rate of borrowing for the year compared to PWLB rates; and
(ii) Investments – Internal returns compared with the 7 day LIBID rate.

The results of these indicators will be reported in the Treasury Annual Report.

14. TREASURY MANAGEMENT ADVISERS

14.1 The Commissioner uses Link Asset Services as treasury management advisors. The company provides a range of services which include:

(i) Technical support on treasury matters, capital finance issues and code compliance;
(ii) Economic and interest rate analysis;
(iii) Debt services which includes advice on the timing of borrowing;
(iv) Debt rescheduling advice surrounding the existing portfolio;
(v) Generic investment advice on interest rates, timing and investment instruments; and
(vi) Credit ratings/market information service comprising the three main credit rating agencies.

14.2 Whilst the advisers provide support to the internal treasury function, under current market rules and the CIPFA Code of Practice the final decision on treasury matters remains with the Commissioner.

15. TREASURY MANAGEMENT TRAINING

15.1 Officer training needs are assessed on appointment, as part of the Personal Development Review (PDR) process and when legislation changes are announced. Officers attend seminars arranged by Link Asset Services and other organisations. Staff within the Office of the Police and Crime Commissioner and Joint Audit Committee members also receive periodic Treasury Management training.