

The Nottinghamshire Office of the Police & Crime Commissioner

## **Treasury Management Strategy**

### Minimum Revenue Provision Policy Statement and Annual Investment Strategy

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2020-21

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## **1. INTRODUCTION**

### **1.1 Background**

The Nottinghamshire Office of the Police and Crime Commissioner (NOPCC) 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 needed. Surplus monies are invested in low risk counterparties or instruments commensurate with the Police and Crime 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 borrowing need, and longer term cash flow planning to ensure that the NOPCC can meet its capital spending obligations. This management of longer term cash may involve arranging long or short term loans. If advantageous debt previously borrowed may be restructured to meet NOPCC risk or cost objectives.

The responsible officer for treasury management is the Chief Finance Officer to the Police & Crime Commissioner (CFO). CIPFA defines treasury management 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."*

### **1.2 Reporting requirements**

The Commissioner is required to receive and approve, as a minimum, three main reports each year, which incorporate a variety of polices, estimates and actuals.

**Prudential and treasury indicators and treasury strategy** (this report) - The first and most important report covers:

- A summary of the capital plans (see also the strategy report), prudential indicators and borrowing plans
- The minimum revenue provision (MRP) policy (how residual capital expenditure is charged to revenue over time)
- The treasury management strategy (how the investments and borrowings are to be organised) including treasury indicators
- The investment strategy (the parameters for managing investments)
- Information regarding non treasury investments such as property

**A mid-year treasury management report** – This will update the Commissioner with the capital position regarding capital, and amend prudential indicators as necessary. It also monitors whether the treasury activity is meeting the strategy and whether any policies require revision.

**An annual treasury report** – This provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

**A detailed capital strategy report** – contained in a separate report

### **Scrutiny**

The responsibility for scrutiny lies with the Commissioner supported by the Audit and Scrutiny Panel. The above reports are reviewed at the Strategic Resources and Performance meetings of the Commissioner.

The values within the strategy have been rounded appropriately, and the extent of rounding is clearly labelled. This rounding will in some cases cause a note to be apparently mathematically incorrect.

## **1.3 Treasury Management Strategy 2020-21**

The strategy covers two main areas:

### **Capital issues**

- capital plans and the prudential indicators
- minimum revenue provision (MRP) policy

### **Treasury management issues**

- current treasury position
- treasury indicators which limit the treasury risk and activities of the NOPCC
- prospects for interest rates
- borrowing strategy
- policy on borrowing in advance of need
- debt rescheduling
- the investment strategy
- creditworthiness policy
- policy on use of external service providers
- Policy on use non financial investments

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. The Prudential Code has been recently updated and has been fully adopted.

#### **1.4 Treasury management consultants**

NOPCC uses Link Asset Services as its external treasury management advisors.

NOPCC recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon our external advisors.

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 CFO 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.

#### **1.5 Training**

The CIPFA Code requires that the responsible officer ensures that relevant personnel receive adequate training in treasury management. This especially applies to the Commissioner who is responsible for scrutiny. Training for the Commissioner was formally delivered in March 2014, and the Chief Financial Officer to the Commissioner (CFO) has provided subsequent updates, after attending relevant seminars during the year. The officers involved in treasury management also receive training from Link Asset Services.

## **2. THE CAPITAL PRUDENTIAL INDICATORS 2020-21 to 2024-25**

The Commissioner's capital expenditure plans are the key driver of treasury management activity. The output of the capital expenditure plans is reflected in prudential indicators, to give an overview and confirm capital expenditure plans. Full information regarding capital expenditure plans is included within the separate capital strategy report and capital programme report.

### **2.1 Capital expenditure**

This prudential indicator is a summary of the Commissioner's capital expenditure plans, both those agreed previously, and those forming part of this budget cycle.

The Commissioner is asked to approve the capital expenditure forecasts, excluding other long term liabilities, such as Private Finance Initiatives (PFI) and leasing arrangements, which already include borrowing instruments.

The table below summarises the capital expenditure plans and how these plans are being financed by capital or revenue resources. Any shortfall of resources results in a net financing need.

Capital Expenditure	2018-19 Actual £m	2019-20 Estimate £m	2020-21 Estimate £m	2021-22 Estimate £m	2022-23 Estimate £m	2023-24 Estimate £m	2024-25 Estimate £m
<b>Capital Programme</b>	<b>9.653</b>	<b>8.720</b>	<b>34.589</b>	<b>16.457</b>	<b>6.015</b>	<b>2.912</b>	<b>3.707</b>
<b>Financed by:</b>							
Capital Receipts	(2.715)	(2.682)	(2.524)	0.000	0.000	0.000	0.000
Capital Grants & Contributions	(0.753)	(0.758)	(0.200)	(0.100)	0.000	0.000	0.000
Direct Revenue Financing	0.000	0.000	(7.000)	0.000	0.000	0.000	0.000
Capital Reserve	(0.250)	0.000	(6.800)	(3.000)	(2.200)	0.000	0.000
<b>Net Financing need</b>	<b>5.935</b>	<b>5.280</b>	<b>18.065</b>	<b>13.357</b>	<b>3.815</b>	<b>2.912</b>	<b>3.707</b>

It is currently estimated that the capital programme for 2019-20 will slip by a total of £5.581m. The borrowing relating to this will also slip and a revised programme and its financing will be produced once this is confirmed.

### **2.2 Commissioner's borrowing need (Capital Financing Requirement)**

The second prudential indicator is the Capital Financing Requirement (CFR). The CFR is simply the total historic outstanding capital expenditure, which has not yet been financed from either revenue or capital resources. It is essentially a measure of the underlying borrowing need. Any capital expenditure above, which has not immediately been financed, will increase the CFR.

The CFR does not increase indefinitely, as the minimum revenue provision (MRP) is a statutory annual revenue charge, which broadly reduces the borrowing need in line with each assets life.

The CFR includes any other long term liabilities (e.g. PFI schemes and finance leases). Whilst these increase the CFR, and therefore the borrowing requirement, these types of scheme include a borrowing facility and so the Commissioner is not required to separately borrow for these schemes.

The Commissioner is asked to approve the CFR projections below:

Capital Financing Requirement (CFR)	2018-19 Actual £m	2019-20 Estimate £m	2020-21 Estimate £m	2021-22 Estimate £m	2022-23 Estimate £m	2023-24 Estimate £m	2024-25 Estimate £m
<b>Total CFR</b>	61.224	63.677	78.743	88.272	87.476	85.213	83.631
<b>Movement in CFR</b>	3.519	2.453	15.066	9.529	(0.796)	(2.263)	(1.582)

Movement in CFR represented by	2018-19 Actual £m	2019-20 Estimate £m	2020-21 Estimate £m	2021-22 Estimate £m	2022-23 Estimate £m	2023-24 Estimate £m	2024-25 Estimate £m
Net financing need for the year (above)	5.935	5.280	18.065	13.357	3.815	2.912	3.707
Less MRP/VRP and other financing movements	(2.416)	(2.827)	(2.999)	(3.828)	(4.611)	(5.175)	(5.289)
<b>Movement in CFR</b>	3.519	2.453	15.066	9.529	(0.796)	(2.263)	(1.582)

N.B. The code does not require the reporting of estimated downward movements to CFR, but this information is included for completeness.

### 2.3 Minimum Revenue Provision (MRP) policy statement

NOPCC is required to pay off an element of the accumulated General Fund capital spend each year (the CFR) through a revenue charge (the minimum revenue provision - MRP). Additional voluntary payments are also allowed. It is at the CFO's discretion to reverse these additional payments at future dates if deemed necessary or prudent. Payments included in annual PFI or finance leases are applied as MRP.

A change introduced by the revised MHCLG MRP Guidance was the allowance that any charges made over the statutory minimum revenue provision (MRP), voluntary revenue provision or overpayments, can, if needed, be reclaimed in later years if deemed necessary or prudent. In order for these sums to be reclaimed for use in the budget, this policy must disclose the cumulative overpayment made each year.

The additional provision that has been made to date is shown in the table below:

Additional Revenue Provision	£m
2016-17	0.750
2017-18	0.250
<b>Total Additional Provision</b>	<b>1.000</b>

Ministry of Housing, Communities and Local Government (MHCLG) regulations have been issued, which require the Commissioner to approve an MRP Statement in advance of each year. A variety of options are available to the Commissioner, as long as there is a prudent provision. No change is proposed from last year.

***The Commissioner is recommended to approve the following MRP Statement:***

*The Commissioner will set aside an amount for MRP each year, which is deemed to be both prudent and affordable. This will be after considering statutory requirements and relevant guidance from the MHCLG.*

#### **2.4 Core funds and expected investment balances**

The application of resources (capital receipts, grants, reserves etc.) to either finance capital or revenue expenditure, will reduce investments unless replaced by asset sales or an underspend on revenue. Detailed below are estimates of the year end resource balances and anticipated daily cash flow balances:

	2018-19 Actual £m	2019-20 Estimate £m	2020-21 Estimate £m	2021-22 Estimate £m	2022-23 Estimate £m	2023-24 Estimate £m	2024-25 Estimate £m
Fund balances/Reserves	22.755	23.741	15.838	14.607	14.248	14.389	14.530
Capital Receipts	3.000	2.524	0.000	0.000	0.000	0.000	0.000
Provisions	3.936	3.936	3.936	3.936	3.936	3.936	3.936
Other	(2.720)	(2.720)	(2.720)	(2.720)	(2.720)	(2.720)	(2.720)
<b>Total Core funds</b>	<b>26.971</b>	<b>27.481</b>	<b>17.054</b>	<b>15.823</b>	<b>15.464</b>	<b>15.605</b>	<b>15.746</b>
<b>Working Capital*</b>	<b>(0.298)</b>	<b>(0.298)</b>	<b>(0.298)</b>	<b>(0.298)</b>	<b>(0.298)</b>	<b>(0.298)</b>	<b>(0.298)</b>
<b>(Under)/Over borrowing</b>	<b>(13.217)</b>	<b>(11.346)</b>	<b>(12.094)</b>	<b>(12.526)</b>	<b>(10.018)</b>	<b>(7.081)</b>	<b>(4.162)</b>
<b>Expected Investments</b>	<b>13.456</b>	<b>15.837</b>	<b>4.662</b>	<b>2.999</b>	<b>5.148</b>	<b>8.226</b>	<b>11.286</b>

\*Working capital balances shown are estimated as at the year-end; these may vary throughout the year

#### **2.5 Affordability**

The previous sections cover the overall capital and control of borrowing prudential indicators, but within this framework prudential indicators are required to assess the affordability of the capital investment plans. These provide an indication of the impact of the capital investment plans on the Commissioners overall finances.

***The Commissioner is requested to approve the following indicators:***

**2.6 Ratio of financing costs 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. This indicator is not a mandatory indicator under the revised code, but it has been reviewed and considered a good indication of the commitment from capital spending.

The estimates of financing costs include commitments and a reasonable assessment of forthcoming capital proposals.

Ratio	2018-19 Actual	2019-20 Estimate	2020-21 Estimate	2021-22 Estimate	2022-23 Estimate	2023-24 Estimate	2024-25 Estimate
	1.8%	1.9%	2.1%	2.7%	3.1%	3.3%	3.4%

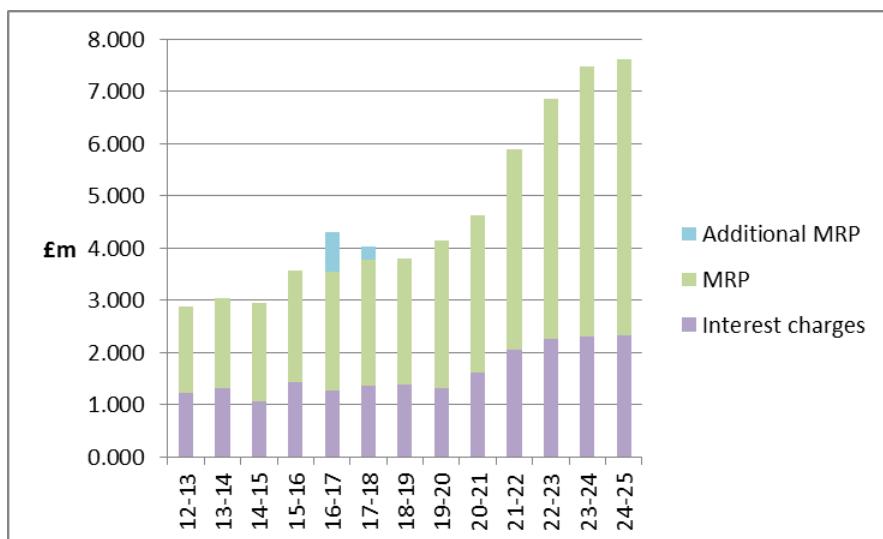
**2.7 Incremental impact of capital investment decisions on council tax**

This indicator identifies the revenue costs associated with a reasonable assessment of forthcoming capital proposals, compared to the Commissioners existing approved commitments and current plans. The assumptions are based on current plans, but will invariably include some estimates, such as the level of Government support, which is not published over a three year period. Again this indicator is not a mandatory indicator under the revised code, but it has been reviewed and considered a good indicator of the commitment from capital spending.

**Incremental impact of capital investment decisions on the band D council tax**

Ratio	2018-19 Actual	2019-20 Estimate	2020-21 Estimate	2021-22 Estimate	2022-23 Estimate	2023-24 Estimate	2024-25 Estimate
	£0.24	-£0.46	£1.17	£5.28	£8.53	£10.57	£11.18

The graph below shows the financial impact of capital expenditure and borrowing on the Revenue Account:



### **3. BORROWING**

The treasury management function ensures that the Commissioners cash is organised in accordance with the relevant professional codes, so that sufficient cash is available to meet the capital expenditure plan summarised in Section 2. This will involve both the organisation of the cash flow, including the arrangement of borrowing as appropriate. The strategy covers the relevant treasury/prudential indicators, the current and projected debt positions and the annual investment strategy.

#### **3.1 Current portfolio position**

The Commissioners borrowing portfolio position at March 2019, with forward projections is summarised below. The table shows external debt against the underlying capital borrowing need (the Capital Financing Requirement – CFR), highlighting any over or under borrowing.

	2018-19 Actual £m	2019-20 Estimate £m	2020-21 Estimate £m	2021-22 Estimate £m	2022-23 Estimate £m	2023-24 Estimate £m	2024-25 Estimate £m
<b>External Debt</b>							
Debt at 1 April	37.169	51.349	55.673	69.991	79.088	80.800	81.474
New Borrowing	15.000	5.280	18.065	13.357	3.815	2.912	3.707
Borrowing Repaid	(0.820)	(0.956)	(3.747)	(4.260)	(2.103)	(2.238)	(2.370)
Movement in Borrowing	14.180	4.324	14.318	9.097	1.712	0.674	1.337
<b>Debt as at 31 March</b>	<b>51.349</b>	<b>55.673</b>	<b>69.991</b>	<b>79.088</b>	<b>80.800</b>	<b>81.474</b>	<b>82.811</b>
Capital Financing Requirement	61.224	63.677	78.743	88.272	87.476	85.213	83.631
Other longterm liabilities	3.342	3.342	3.342	3.342	3.342	3.342	3.342
Underlying Borrowing Need	64.566	67.019	82.085	91.614	90.818	88.555	86.973
<b>Under/(over) borrowing</b>	<b>13.217</b>	<b>11.346</b>	<b>12.094</b>	<b>12.526</b>	<b>10.018</b>	<b>7.081</b>	<b>4.162</b>
<b>Investments</b>	13.456	15.837	3.862	2.499	5.148	8.226	11.286
<b>Net Debt</b>	<b>37.893</b>	<b>39.836</b>	<b>66.129</b>	<b>76.589</b>	<b>75.652</b>	<b>73.248</b>	<b>71.525</b>

Within the prudential indicators there are a number of key indicators to ensure that activities operate within well defined limits. One of these is that the Commissioner needs to ensure that his 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 2020-21 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 CFO reports that this prudential indicator will be complied with in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans, and the proposals in this budget report.

### 3.2 Treasury Indicators - Limits to borrowing activity

**Operational boundary.** This is the limit beyond which external debt is not normally expected to exceed. In most cases, this would be a similar figure to the CFR.

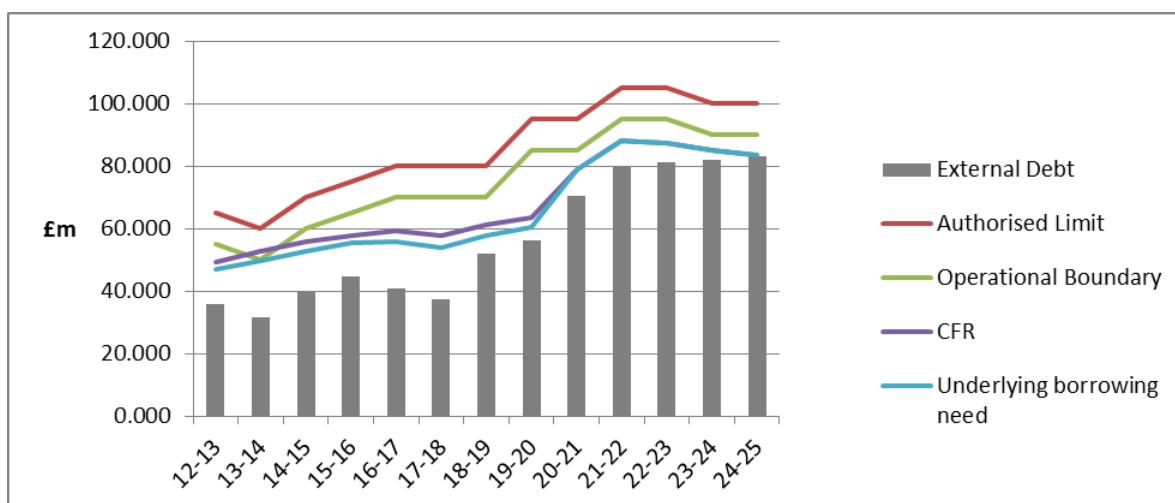
Operational Boundary	2019-20 Forecast £m	2020-21 Estimate £m	2021-22 Estimate £m	2022-23 Estimate £m	2023-24 Actual £m	2024-25 Actual £m
	85.000	85.000	95.000	95.000	90.000	90.000

**Authorised limit.** A further key prudential indicator representing a control on the maximum level of borrowing. This is 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.

***The Commissioner is requested to approve the following authorised limit:***

Authorised Limit	2019-20 Forecast £m	2020-21 Estimate £m	2021-22 Estimate £m	2022-23 Estimate £m	2023-24 Actual £m	2024-25 Actual £m
	95.000	95.000	105.000	105.000	100.000	100.000

The graph below shows CFR and debt figures from paragraphs 2.2 and 3.1 compared with relevant borrowing limits.



### 3.3 Prospects for interest rates and economic background

One of the services provided by Link Asset Services is to assist the Commissioner in formulating a view on interest rates. The table below gives the view as at 23<sup>rd</sup> December 2019.

Link Asset Services Interest Rate View														
	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23
Bank Rate View	0.75	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.00	1.25	1.25	1.25	1.25
3 Month LIBID	0.70	0.70	0.70	0.80	0.90	1.00	1.00	1.00	1.10	1.20	1.30	1.30	1.30	1.30
6 Month LIBID	0.80	0.80	0.80	0.90	1.00	1.10	1.10	1.20	1.30	1.40	1.50	1.50	1.50	1.50
12 Month LIBID	1.00	1.00	1.00	1.10	1.20	1.30	1.30	1.40	1.50	1.60	1.70	1.70	1.70	1.70
5yr PWLB Rate	2.30	2.40	2.40	2.50	2.50	2.60	2.70	2.80	2.90	2.90	3.00	3.10	3.20	3.20
10yr PWLB Rate	2.60	2.70	2.70	2.70	2.80	2.90	3.00	3.10	3.20	3.20	3.30	3.30	3.40	3.50
25yr PWLB Rate	3.20	3.30	3.40	3.40	3.50	3.60	3.70	3.70	3.80	3.90	4.00	4.00	4.10	4.10
50yr PWLB Rate	3.10	3.20	3.30	3.30	3.40	3.50	3.60	3.60	3.70	3.80	3.90	3.90	4.00	4.00

The above forecasts have been based on an assumption that there is an agreed deal on Brexit, including agreement on the terms of trade between the UK and EU, at some point in time. The result of the general election has removed much uncertainty around this major assumption. However, it does not remove uncertainty around whether agreement can be reached with the EU on a trade deal within the short time to December 2020, as the prime minister has pledged.

It has been little surprise that the Monetary Policy Committee (MPC) has left Bank Rate unchanged at 0.75% so far in 2019 due to the ongoing uncertainty over Brexit and the outcome of the general election. In its meeting on 7 November, the MPC became more dovish due to increased concerns over the outlook for the domestic economy if Brexit uncertainties were to become more entrenched, and for weak global economic growth: if those uncertainties were to materialise, then the MPC were likely to cut Bank Rate. However, if they were both to dissipate, then rates would need to rise at a “gradual pace and to a limited extent”. Brexit uncertainty has had a dampening effect on UK GDP growth in 2019, especially around mid-year. There is still some residual risk that the MPC could cut Bank Rate as the UK economy is still likely to only grow weakly in 2020 due to continuing uncertainty over whether there could effectively be a no deal Brexit in December 2020 if agreement on a trade deal is not reached with the EU. Until that major uncertainty is removed, or the period for agreeing a deal is extended, it is unlikely that the MPC would raise Bank Rate.

During the first half of 2019-20 to 30 September, gilt yields plunged and caused a near halving of longer term PWLB rates to completely unprecedented historic low levels. The overall longer run future trend is for gilt yields, and consequently PWLB rates, to rise, albeit gently. From time to time, gilt yields, and therefore PWLB rates, can be subject to exceptional levels of volatility due to geo-political, sovereign debt crisis, emerging market developments and sharp changes in investor sentiment.

Such volatility could occur at any time during the forecast period. In addition, PWLB rates are subject to ad hoc decisions by **H.M. Treasury** to change the margin over gilt yields charged in PWLB rates: such changes could be up or down. It is not clear that if gilt yields were to rise back up again by over 100bps within the next year or so, whether H M Treasury would remove the extra 100 bps margin implemented on 9<sup>th</sup> October 2019.

#### **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** 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**. Weak capitalisation of some **European banks**, particularly Italian banks.
- **German minority government**.
- **Other minority EU governments**. Austria, Finland, Sweden, Spain, Portugal, Netherlands and Belgium also have vulnerable minority governments dependent on coalitions, which could prove fragile.
- **Austria, the Czech Republic, Poland and Hungary** now form a strongly anti-immigration bloc within the EU. There has also been rising anti-immigration sentiment in Germany and France.
- In October 2019, the IMF issued a report on the World Economic Outlook which flagged up a synchronised slowdown in world growth. However, it also flagged up that there was **potential for a rerun of the 2008 financial crisis**, but this time centred on the huge debt binge accumulated by corporations during the decade of low interest rates.
- **Geopolitical risks**, for example in 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 agreement was reached all round that removed all threats of economic and political disruption between the EU and the UK.
- The **Bank of England is too slow** in its pace and strength of increases in Bank Rate and, therefore, allows inflationary 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.

## **Investment and borrowing rates**

- Investment returns are likely to remain low during 2020/21 with little increase in the following two years. However, if major progress was made with an agreed Brexit, then there is upside potential for earnings.
- Borrowing interest rates were on a major falling trend during the first half of 2019-20 but then jumped up by 100 bps on 9.10.19. The policy of avoiding new borrowing by running down spare cash balances has served local authorities well over the last few years. However, the unexpected increase of 100 bps in PWLB rates requires a major rethink of local authority treasury management strategy and risk management

While the NOPCC will not be able to avoid borrowing to finance new capital expenditure, replace maturing debt or avoid the complete rundown of reserves, there will be a cost of carry, (the difference between higher borrowing costs and lower investment returns), to any new short or medium-term borrowing that causes a temporary increase in cash balances as this position will, most likely, incur a revenue cost.

Against this background and the risks within the economic forecast, caution will be adopted with the 2020-21 treasury operations. The CFO will monitor interest rates and financial markets and adopt a pragmatic approach to changing circumstances.

## **Treasury Management limits on activity**

There are three debt related treasury activity limits. The purpose of these are to constrain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of any adverse movement in interest rates. However, if these are set too restrictively they will impair the opportunities to reduce costs/improve performance.

The indicators are:

**Upper limits on variable interest rate exposure.** This identifies a maximum limit for variable interest rates based upon the debt position net of investments

**Upper limits on fixed interest rate exposure.** This gives a maximum limit on fixed interest rates;

**Maturity structure of borrowing.** These gross limits are set to reduce the exposure to large fixed rate sums falling due for refinancing.

***The Commissioner is requested to approve the following treasury indicators and limits:***

<b>Upper Interest rate exposures 2020-21 to 2022-23</b>		
Limits on fixed interest rates:		
• Debt only		100%
• Investments only		100%
Limits on variable interest rates		
• Debt only		50%
• Investments only		100%
<b>Maturity structure of fixed interest rate borrowing 2020-21 to 2022-23</b>		
	<b>Lower</b>	<b>Upper</b>
Under 12 months	0%	30%
12 months to 2 years	0%	40%
2 years to 5 years	0%	50%
5 years to 10 years	0%	70%
10 years and above	0%	100%

### **3.4 Policy on borrowing in advance of need**

NOPCC will not borrow more than, or in advance of its needs purely in order to profit from the investment of 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 security of such funds is considered.

Borrowing in advance will be made within the following constraints:

- It will be limited to no more than 50% of the expected increase in borrowing need (CFR) over the three year planning period
- Would not be more than 18 months in advance of need

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

### **3.5 Debt rescheduling**

Rescheduling of current borrowing in our debt portfolio is unlikely to occur as the 100 bps increase in PWLB rates only applied to new borrowing rates and not to premature debt repayment rates.

Following the decision by the PWLB on 9<sup>th</sup> October 2019 to increase their margin over gilt yields by 100 bps to 180 basis points on loans lent to local authorities, consideration will also need to be given to sourcing funding at cheaper rates from the following:

- Local authorities (primarily shorter dated maturities)
- Financial institutions (primarily insurance companies and pension funds but also some banks, out of spot or forward dates)
- Municipal Bonds Agency (no issuance at present but there is potential)

The degree which any of these options proves cheaper than PWLB Certainty Rate is still evolving at the time of writing, but our advisors will keep us informed.

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 compared to the cost of debt repayment (premiums incurred). Also the current treasury position needs due consideration.

The reasons for any rescheduling to take place will include:

- the generation of cash savings and/or discounted cash flow savings
- helping to fulfil the treasury strategy
- enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility)

Consideration will also be given to identify if there is any 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.

All rescheduling will be reported to the Commissioner at the earliest opportunity.

### **3.6 Municipal Bond Agency**

It is possible that the Municipal Bond Agency, will be offering loans to Local Authorities in the near future at borrowing rates lower than those offered by the Public Works Loan Board (PWLB). The Commissioner intends to make use of this new source of borrowing if it becomes available.

## **4. ANNUAL INVESTMENT STRATEGY**

### **4.1 Investment Policy**

The Commissioner's investment policy has regard to the MHCLG's Guidance on Local Government Investments ("the Guidance") and CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes. The Commissioner's investment priorities will be security first, liquidity second and then return.

In accordance with guidance from the MHCLG and CIPFA, and in order to minimise the risk to investments, the NOPCC has below clearly stipulated the minimum acceptable credit quality of counterparties for inclusion on the lending list. This enables diversification and avoids the concentration of risk. The key ratings used to monitor counterparties are the Short Term and Long Term ratings.

The aim of the strategy is to generate a list of highly creditworthy counterparties which will also enable diversification and thus avoidance of concentration risk. Therefore, providing security of investment and minimisation of risk.

Ratings will not be the sole determinant of the quality of an institution; it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets, by actively engaging with advisors to maintain monitoring on market pricing such as "credit default swaps" and overlay that information on top of the credit ratings.

Other information sources used will include the financial press, share price and other such information regarding the banking sector. This allows a robust scrutiny process on investment counterparties.

At the end of the financial year, the CFO will report on the investment activity as part of the Annual Treasury Report.

### **4.2 Non-financial Investments Policy**

Non-financial investments are essentially the purchase of income yielding assets. Currently radio masts are held and income is received for an item that is no longer operational. They were not acquired with that as a purpose, and were originally operational. The current income yield is circa £0.090m per annum. There is no intention to purchase these kinds of investments and any divergence from this would be the subject of a future report.

#### **4.3 Creditworthiness Policy**

The primary criterion is the security of investments. The liquidity (availability) of the investments is secondary consideration. The yield (return) on the investment is also a further consideration. The Commissioner will ensure that:

- It maintains a policy covering both the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security, and monitoring their security. This is set out in the specified and non-specified investment sections below:
- It has sufficient liquidity in its investments. For this purpose it will set out procedures 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.

The CFO will maintain a counterparty list in compliance with the following considerations and will keep the criteria under review. It provides an overall pool of counterparties considered high quality which the Commissioner may use, rather than defining what types of investment instruments are to be used.

The lowest credit rating from the main agencies is used when considering counterparties. It is considered that this does not significantly increase risk but may widen the pool of available counter parties. Credit rating information is supplied by Link Asset Services, 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. Link Asset Services updates counterparties who qualify under the list on a daily basis.

**UK banks – ring fencing** - The largest UK banks, (those with more than £25bn of retail/Small and Medium-sized Enterprise (SME) deposits), are required, by UK law, to separate core retail banking services from their investment and international banking activities by 1<sup>st</sup> January 2019. This is known as “ring-fencing”. Whilst smaller banks with less than £25bn in deposits are exempt, they can choose to opt up. Several banks are very close to the threshold already and so may come into scope in the future regardless.

Ring-fencing is a regulatory initiative created in response to the global financial crisis. It mandates the separation of retail and SME deposits from investment banking, in order to improve the resilience and resolvability of banks by changing their structure. In general, simpler activities offered from within a ring-fenced bank,

(RFB), will be focused on lower risk, day-to-day core transactions, whilst more complex and “riskier” activities are required to be housed in a separate entity, a non-ring-fenced bank, (NRFB). This is intended to ensure that an entity’s core activities are not adversely affected by the acts or omissions of other members of its group.

While the structure of the banks included within this process may have changed, the fundamentals of credit assessment have not. The Commissioner will continue to assess the new-formed entities in the same way that it does others and those with sufficiently high ratings, (and any other metrics considered) will be considered for investment purposes.

**Country and sector considerations** - Due care will be taken to consider the country, group and sector exposure of the Commissioners investments. In addition to the considerations already outlined the limits in place will apply to a group of companies and sector limits will be monitored regularly for appropriateness. Investments will only be made in sterling.

**Use of additional information other than credit ratings** - Additional requirements under the Code requires 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 and relevant news articles) will be applied to compare the relative security of differing investment counterparties.

**Time and monetary limits applying to all investments.** The time and monetary limits for institutions on the Commissioners counterparty list are as follows: No changes are proposed. The range of values for Low Volatility Net Asset Value Funds and Ultra Short Dated Bond Funds have the lower limit being the ‘normal limit’ and above this being at the CFO’s discretion.

	Fitch Long term Rating (or equivalent)	Money and/or % Limit	Time Limit
Banks 1 higher quality	AAA	£5m	1 yr
Banks 1 medium quality	AA-	£5m	1 yr
Banks 1 medium/lower quality	A	£4m	6 month
Banks 1 Lower quality	A-	£3m	3 months
Banks 2 – part nationalised	N/A	£5m	1yr
<b>Additional criteria for non UK Banks</b>			
Sovereign	AA-		
Country		25%/£5m	
Banks 3 category – Commissioners banker (not meeting Banks 1)	N/A	£5m	1 day
UK Govt - DMADF	AAA	Unlimited	6 months
Local authorities	N/A	£8m	2 yr
Low Volatility Net Asset Value Funds (LVNAV) (Used to be called Enhanced money market funds with instant access)	AAA	£12/15m	liquid
Ultra Short Dated Bond Funds (Used to be called Enhanced money market funds with notice)	AAA	£3/5m	liquid

#### 4.4 Country Limits

The Commissioner has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of AA- from Fitch. For information the UK has maintained an AA rating.

## Approved Non UK countries for investments as at 23<sup>rd</sup> December 2019

*Based on lowest available rating*

AAA	AA+	AA	AA-
Australia	Finland	Abu Dhabi	Belgium
Canada	U.S.A.	France	Qatar
Denmark		Hong Kong	
Germany			
Luxembourg			
Netherlands			
Norway			
Singapore			
Sweden			
Switzerland			

### 4.5 Investment Strategy

**In-house funds.** Investments will be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates (up to 12 months).

**Investment returns expectations** - On the assumption that the UK and EU agree a Brexit deal including the terms of trade by the end of 2020 or soon after, then Bank Rate is forecast to increase only slowly over the next few years to reach 1.00% by quarter 1 2023. Bank Rate forecasts for financial year ends (March) are:

- Q1 2021 0.75%
- Q1 2022 1.00%
- Q1 2023 1.00%

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.

The forecast earnings rates for returns on investments placed for periods up to 3 months are as follows:

- 2019-20 0.75%
- 2020-21 0.75%
- 2021-22 1.00%
- 2022-23 1.25%
- 2023-24 1.50%
- 2024-25 1.75%
- Later years 2.25%

**Investment treasury indicator and limit** - total principal funds invested for greater than 365 days are limited with regard to liquidity requirements and to reduce the need for early redemption.

***The Commissioner is requested to approve the treasury indicator and limit:***

Maximum principal sums invested > 365 days	2019-20 £m	2020-21 £m	2021-22 £m	2022-23 £m	2023-24 £m	2024-25 £m
	5.000	5.000	5.000	5.000	5.000	5.000

There are currently no funds invested for greater than 365 days. For cash flow generated balances, the CFO will seek to utilise instant access and notice accounts, LVNAVs and short-dated deposits (overnight to 100 days) in order to benefit from the compounding of interest. Ultra Short Dated Bond Funds will be used if considered appropriate by the CFO.

#### **4.6 Investment Risk Benchmarking**

These benchmarks are simple guides to maximum risk, and may be breached occasionally, depending on circumstances. The purpose of the benchmarks 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.

**Security** - The Commissioner's maximum security risk benchmark for the current portfolio, when compared to these historic default tables, is 0.06% historic risk of default when compared to the whole portfolio.

**Liquidity** - in respect of this area the Commissioner seeks to maintain:

- Bank overdraft - avoided if possible
- Liquid short term deposits of at least £5.0m available on instant access
- Weighted average life benchmark is expected to be 1 month, with a maximum of 6 months

**Yield** - local measures of yield benchmarks is that investments achieve returns above the 7 day LIBID rate.

## **SECTION 151 OFFICER**

### **5.1 Treasury Management Role**

The S151 (responsible) officer is the Chief Financial Officer to the Commissioner and they have responsibility for the following:

- Recommending clauses, treasury management policy/practices for approval, reviewing the same regularly, and monitoring compliance
- Submitting regular treasury management policy reports
- Submitting budgets and budget variations
- Receiving and reviewing management information reports
- Reviewing the performance of the treasury management function
- Ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function
- Ensuring the adequacy of internal audit, and liaising with external audit
- Recommending the appointment of external service providers