

22 May 2017

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## **TREASURY MANAGEMENT STRATEGY 2017/2018**

### **Purpose of the Report**

1. This report discusses and asks the Commissioner to approve:
  - a) The proposed Prudential (PrIs) and Treasury (TrIs) Indicators for the next three years (Appendix A);
  - b) The proposed Annual Investment Strategy for 2017/2018; and
  - c) Other Treasury management decisions required for 2017/2018 that do not form part of the PrIs/TrIs (paragraphs 13 to 17 below).

### **Background**

2. Normally prior to the start of each financial year, the Commissioner has to consider and approve a Treasury Management Strategy (TMS), which incorporates the Prudential and Treasury Indicators and an Annual Investment Strategy. This is required under the provisions of the latest CIPFA Code of Practice on Treasury Management in the Public Services (the CIPFA Code) and the Prudential Code for Capital Finance in Local Authorities (the Prudential Code). This year this paper has been delayed and hence is being circulated for approval post 1 April.
3. Before looking at the TMS for 2017/2018 I need to review the current year's treasury management activity. I normally estimate the cash position at 31 March 2017 however due to the delay I can report the actual.

### **Treasury Management Strategy - Review of 2016/2017**

4. A detailed analysis of the 2016/2017 activities will be made in the Annual Treasury Report to be submitted to the Commissioner in June, but a brief review needs to be made reporting the position at the end of 2016/2017.
5. In January 2017 the Commissioner was informed of a revised forecast cash flow deficit for the year of £3 million. The actual cash flow for 2016/17 is a £5.4 million deficit this will be discussed in the outturn report.
6. Surplus funds invested at 31 January 2017 stood at £23.5 million, £23.0 million invested in the market and £0.5 million in an instant access call account. At this date the total funds (i.e. £23.0 million) invested in the market were all in longer term deposits (for between 6 - 12 months). This money is being invested directly by our local treasury managers (Wiltshire Council) in short-term, approved investments or overnight as HSBC deposits. An analysis of the annual return will be given in the Annual Treasury Report in June 2017 but performance to 31 January 2017 is shown in paragraph 18.

### **Main Considerations for the Commissioner – Treasury Management Strategy**

#### **Prudential and Treasury Indicators**

7. The Prudential and Treasury Indicators are of a somewhat theoretical interest, because of our debt-free status. Nevertheless, they do still have to be calculated and formally approved.

8. Issues of affordability, prudence and sustainability of borrowing are of limited relevance when the PCC is debt-free. However, the Prls/Trls for borrowing limits, interest rate exposures and maturity structures still have to be considered because short-term borrowing may be necessary to cover in-year cash flow deficits. We will only have to consider the more fundamental issues of affordability, prudence and sustainability in detail if the PCC were to decide to borrow.
9. Our debt-free nature does not exempt the PCC from non-debt related responsibilities under the Prudential Code - to ensure value for money (robust option appraisal) and practicality of capital investment, proper stewardship of assets (asset management planning) and sound links to service objectives.
10. The proposed Prls and Trls are set out in Appendix A, together with a brief summary on each one.
11. The PCC is still required to continue to comply with the CIPFA Code and the Investment Guidance in respect of the treasury management carried out by Wiltshire Council on its behalf. This principally involves the setting of the Investment Strategy for the year to be followed by Wiltshire Council in overseeing the management of surplus cash.
12. The proposed Investment Strategy for 2017/2018 is set out in Appendix B.

#### Operating leases

13. Although there will not be restrictions on capital expenditure approvals, the strategy needs to allow for the possible use of operating leases to finance certain items of a capital nature, notably vehicles and computer hardware. A sum of £0.5 million is suggested.

#### Cash Deficits and Surpluses

##### *Short Term Deficits and Surpluses*

14. Short term cash surpluses and deficits will arise regularly during the year. It is anticipated that the majority of these surpluses will only be available on a very temporary basis. Short term deposits are the most cost effective investment for such cash surpluses. Therefore, investments will normally be made through short term deposits at fixed rates to specific dates, with reference to the cash flow requirements.
15. Temporary loans (where both the borrower and lender have the option to redeem the loan within twelve months) are occasionally used to cover short term revenue cash deficits, where this is more cost effective than temporarily withdrawing funds from call accounts, pending the receipt of, for example, grant income.
16. I therefore recommend that the PCC continues to utilise temporary loans and deposits to manage these cash flows.

##### *Longer Term Cash Balances*

17. The longer term balances are managed by Wiltshire Council and are currently held, partly in longer term (above three and up to 12 months) investments and partly in call accounts.
18. The annualised weighted average return of the longer term investments (only) is currently 0.76%, which has decreased from 0.90% in the same period last year. Since

last year the Bank of England base rate has been cut to 0.25% (in August 2016) which has resulted in a similar decrease in money market rates.

19. A comparative benchmark, (the three month London Interbank Bid Rate LIBID), reflecting the rate at which a bank is willing to borrow from other banks, is currently 0.32%.

#### Investment Risk

20. Appendix B identifies the PCC's current approach to investing any surpluses. The strategy is based on high credit quality using the credit list provided by Capita, which includes a credit default swap analysis that effectively provides an early indication of the likelihood that a bank's credit rating will be changed. This should keep any short term investments we have as safe as they could possibly be, even though interest rates may be marginally less attractive.

#### Monitoring and Reporting of the Prudential Indicators

21. Wiltshire Council staff and the finance staff of the PCC will monitor progress against the PrIs/TrIs throughout the year. The PCC will be kept informed of any issues that arise, including potential or actual breaches, as these could be ultra-vires. I will normally update the PCC every six months in the Interim and Annual Treasury Reports.

#### Collaboration

22. The Treasury Management function is outsourced to Wiltshire Council. Using their skills and contacts with market experts it is believed that value for money is achieved alongside good returns.

#### Diversity

23. No diversity issues have been identified

#### Recommendations

24. The Commissioner is asked to:

- a) adopt the Prudential and Treasury Indicators set out in Appendix A;
- b) adopt the Investment Strategy set out in Appendix B;
- c) agree that operating leases of up to £0.5 million can be used to assist in financing the PCC's 2017/2018 capital plans where necessary;
- d) agree that short term cash deficits and surpluses continue to be managed through temporary loans and deposits (paragraph 14 to 16); and
- e) agree that, for longer term cash balances, the Chief Finance Officer continues to be delegated to negotiate the terms and conditions of any external arrangement.

**Clive Barker**  
**Chief Finance Officer to the PCC**

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**PRUDENTIAL (PrIs) AND TREASURY (TrIs) INDICATORS 2017/2018 - 2019/2020****Prudential Indicators****Prl 1 - Capital Expenditure**

1. The capital expenditure plans are set out in the Capital Plan, under the Prudential Code, the PCC is required to confirm this as a Prudential Indicator. Capital expenditure plans for the years 2015/2016 to 2019/2020 is as follows:

	<b>2015/2016 Actual</b>	<b>2016/2017 Est Outturn</b>	<b>2017/2018</b>	<b>2018/2019</b>	<b>2019/2020</b>
Capital Expenditure	£3.3m	£3.5m	£5.5m	£3.2m	£9.5m

**Prl 2 – Ratio of Financing Costs to Net Revenue Stream**

2. Prl 2 expresses the net costs of financing as a percentage of the funding receivable from the Government and council tax payers. The net cost of financing includes interest and principal repayments for long and short term borrowing, as well as other credit-like arrangements, netted off by interest receivable in respect of cash investments. The Prl does not include the revenue contribution to capital expenditure.
3. Of these costs, only interest receivable is at all significant for the PCC (being debt-free) and this means that the resulting Prl is negative.

	<b>2015/2016 Actual</b>	<b>2016/2017 Est Outturn</b>	<b>2017/ 2018</b>	<b>2018/ 2019</b>	<b>2019/ 2020</b>
Ratio of Financing Costs to Net Revenue Stream	-0.2%	-0.2%	-0.2%	-0.2%	-0.2%

**Prl 3 – Estimate of Incremental Impact of Capital Expenditure Decisions on the Council Tax**

4. This Prl shows the incremental impact of the capital investment decisions now proposed in these budget reports on the Council Tax, compared to the estimates disclosed in previous years. Each year a four year capital programme is drawn up. This shows in detail plans for expenditure in the forthcoming year. Future years are more of a skeleton programme and will increase when information is available. The impact this has on the Prl is that there is always likely to be a higher effect in the forthcoming year. This calculation is a notional figure due to the use of capital receipts, grants, etc to fund the programme. Negative indicators occur when capital expenditure reduces from the previous year.

	<b>2017/2018</b>	<b>2018/2019</b>	<b>2019/2020</b>
Effect on Band D Council Tax	£3.22	-£3.75	£10.40

**Prl 4 – Gross Borrowing to Capital Financing Requirement**

5. Prl 4 measures the so-called “Golden Rule” and focuses on prudence.
6. The Capital Financing Requirement normally increases year-on-year by the amount of capital expenditure that is not funded from sources other than borrowing (i.e. government capital grant, capital receipts, developer contributions, direct revenue), reduced by the amount set-aside from the revenue budget and capital receipts for the repayment of debt. Gross Borrowing is the PCC’s long and short term external debt.

	<b>2015/ 2016 Actual</b>	<b>2016/ 2017 Est Outturn</b>	<b>2017/ 2018</b>	<b>2018/ 2019</b>	<b>2019/ 2020</b>
Capital Financing Requirement	£0.0m	£0.0m	£0.0m	£0.0m	£0.0m
Gross Borrowing	£0.0m	£0.0m	£0.0m	£0.0m	£0.0m
<b>Unused Capital Financing Requirement</b>	<b>£0.0m</b>	<b>£0.0m</b>	<b>£0.0m</b>	<b>£0.0m</b>	<b>£0.0m</b>

7. Because this PCC's entire capital programme is funded by cash sources (grants, capital receipts, direct revenue), there is no Capital Financing Requirement and because the PCC is debt free there is also no Gross Borrowing.

Prl 5 – Compliance with CIPFA Code of Practice for Treasury Management in the Public Services

8. This Prl simply confirms compliance with the Code of Practice.

**The PCC is and will continue to be fully compliant with the latest CIPFA Code of Practice for Treasury Management in the Public Services.**

**Treasury Management Indicators within the Prudential Code**

Trl 1 – External debt

9. Under the Prudential Code, three limits must be set by the PCC for External Debt:
- a) Actuals for last year and an estimate for the end of the current year
  - b) An Operational limit for the next three years
  - c) An Authorised limit for the next three years.
10. The Operational limit is based on the most likely, prudent, but not worst case scenario of borrowing. The Authorised limit is based on the Operational limit but with an additional margin (in the PCC's case 15% has been used) to allow for unusual or unexpected cash movements. These borrowing limits are to be set gross of investments.

<b>Actuals</b>	<b>31/3/16 Actual</b>	<b>31/3/17 Actual</b>
Borrowing (Temporary)	£0.0m	£5.5m
Other Long Term Liabilities	£0.0m	£0.0m
<b>TOTAL</b>	<b>£0.0m</b>	<b>£0.0m</b>

11. There was £5.5m of temporary borrowing outstanding as at 31 March 2017. This was in respect of one loan, which was taken with Lancashire County Council at a fixed rate of 0.2% for two weeks to cover a deficit cashflow position. The loan was repaid on 5 April 2017.
12. The PCC has managed to operate on a debt free basis to date and it is anticipated that it can remain in this position throughout the period 2017/2018 to 2019/2020. In these circumstances, the PCC will finance its capital requirement from capital grant, capital receipts, the capital reserve, and direct from revenue.

13. The PCC holds these surplus monies in approved investments in sufficient levels to finance its annual cash flow forecasts for the three years and thus allow it to remain debt free. However, during each year there are fluctuations in cash flow, the highest deficits are forecast as approximately £5.0 million (2017/2018), £5.5 million (2018/2019), and £6.0 million (2019/2020). There may also be a need to pay out capital expenditure prior to receipt of capital income, although previous experience shows that this is unlikely.
14. Invested cash could be reduced to cover these temporary deficits but this may not be the most cost effective approach for the PCC. Limits for temporary borrowing are therefore proposed, to allow flexibility to use borrowing as an alternative way of financing such temporary deficits, if this is in the PCC's best interest. So, whilst the PCC will remain debt free, the following limits should be authorised to deal with possible in-year cash flow shortfalls.

<b>Operational Limit</b>	<b>2017/2018</b>	<b>2018/2019</b>	<b>2019/2020</b>
Annual gross Borrowing	£0.0m	£0.0m	£0.0m
Temporary borrowing	£5.0m	£5.5m	£6.0m
Total Operational limit	£5.0m	£5.5m	£6.0m

<b>Authorised Limit</b>	<b>2017/2018</b>	<b>2018/2019</b>	<b>2019/2020</b>
Annual gross Borrowing	£0.0m	£0.0m	£0.0m
Temporary borrowing	£5.8m	£6.3m	£6.9m
Total Authorised limit	£5.8m	£6.3m	£6.9m

### **Treasury Management Indicators within the Treasury Management Code**

#### **Trl 2 – Interest Rate Exposures**

15. This Trl relates to net borrowing (i.e. borrowing less investments). As the PCC will have no long term borrowing there is no risk to borrowing costs of a change in interest rates. However it does partly rely on returns from invested funds in order to finance revenue and capital expenditure.
16. Future returns will be affected by inflation and the Bank of England's decisions on interest rates. Capita Asset Service's current predictions indicate that the Bank Rate is likely to remain at 0.25% until June 2019, when they anticipate it will increase by 0.25%, to 0.5%. The rate is then predicted to rise again to 0.75% in December 2019. At the moment there is no clear indication of when the Bank of England will start tightening policy by raising rates, however, it is considered unlikely that rates will rise anytime soon. Although, when rates do start to rise, the Bank of England has stated that rises will be gradual. It is impossible to guarantee the returns based on these factors. Reflecting the low returns in 2016/2017 the PCC's budget in 2017/2018 is set on a return of 1%.
17. All funds are internally managed and returns will be maximised whichever way interest rates move. The control of the investments is subject to the approved Annual Investment Strategy and the limits set in this Trl.
18. Any temporary borrowing, as authorised in Trl 1 above, should be taken on a fixed interest rate, as the period of any loan is likely to be only a maximum of a few days. Investments on HSBC Bank Treasury and other financial institutions should also be taken at fixed interest rates.

**The PCC's upper limit for fixed interest rate exposure for the period 2017/2018 to 2019/2020 is 100% of net outstanding principal sums.**

**The PCC's upper limit for variable interest rate exposure for the period 2017/2018 to 2019/2020 is 0% of net outstanding principal sums.**

Trl 3 – Maturity Structure of Borrowing

**While the PCC remains debt free there will be no maturity profile.**

Trl 4 – Total Principal Sums invested for periods longer than 364 days

19. This Trl is covered by the Annual Investment Strategy, which is detailed in the following appendix.

**INVESTMENT STRATEGY FOR 2017/2018**

1. The PCC will have regard to the Department for Communities and Local Government's (DCLG's) Guidance on Local Government Investments ("the Guidance") issued in March 2004, any revisions to that guidance, the Audit Commission's report on Icelandic investments and the 2011 revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code"). The general investment policy of the PCC will be the prudent investment of its surplus cash balances, priorities being:
  - a) the security of capital and
  - b) the liquidity of its investments.
2. Only in so far as is consistent with the priority of security and liquidity, the PCC will aim to achieve the optimum return on its investments.
3. The PCC will not borrow monies purely to invest or lend-on and make a return.
4. All investments of the PCC will be in sterling, as it does not wish to hold investments that are subject to foreign exchange rate risks.
5. All investments made other than those through an External Cash Investment Manager (where applicable – currently no PCC funds are managed by an External Cash Investment Manager) or certain investments placed with local authorities and other public bodies, subject to professional advice will be Specified Investments, as prescribed in the DCLG's Guidance on Local Government Investments (the "Guidance").
6. The investments identified in 5. above are the only non specified investments authorised for use and will only be:
  - a) in Sterling;
  - b) for investments in excess of 12 months, limited to £10 million; and
  - c) not invested for a period exceeding five years.
7. Credit ratings will be monitored on a weekly basis, by the PCC's treasury management providers (Wiltshire Council). The Council uses the creditworthiness service provided by Capita Asset Services. This service is based on a sophisticated modelling approach, with credit ratings from all three rating agencies (Fitch, Moody's and Standard and Poor's), forming the core element. However, it does not rely solely on the current credit ratings of counterparties but also uses the following as overlays:
  - a) credit watches and credit outlooks from credit rating agencies;
  - b) CDS spreads to give early warning of likely changes in credit ratings; and
  - c) sovereign ratings to select counterparties from only the most creditworthy countries.

**"High Credit Quality" Policy**

In accordance with DCLG Guidance on Local Government Investments for selecting the creditworthiness of counterparties with whom investments are placed, the Police and Crime Commissioner will comply with the minimum requirements below.

**All banks and building societies must be part of the credit list provided by Capita. The PCC will only invest with institutions on the list for the durations as specified by the colour coding used by Capita and they must not be shown as out of range (with no colour) on the credit default swap analysis.**

**All Local Authorities and public bodies (ratings are not issued for most of these bodies).**

**Money Market Funds (MMF), must have been awarded the highest possible rating (AAA) from at least one of the credit rating agencies, Standard and Poor's, Moody's Investor Services Ltd and Fitch Ratings Ltd. (Deposits will only be placed with MMFs subject to individual signed management agreements.)**

Limits are applied to the amount of money that can be lent to any of these institutions or groups of institutions using the ratings of Fitch Rating Agency as follows:

**£8 million**

**UK incorporated banks with a short term credit rating of at least F1+ and a long term credit rating of at least AA**

**Overseas banks that have a long term credit rating of at least AA+**

**Local Authorities and other public bodies**

**£5 million**

**Other UK Incorporated banks**

**Other overseas banks**

**Building Societies**

**Money Market Funds**