STAFFORDSHIRE COMMISSIONER
Police | Fire and Rescue | Crime

Report to the Police Fire and Crime Panel – 28th January 2019

Policing Treasury Management Strategy Report 2019/20

Report of the Staffordshire Commissioner

Introduction

In addition to his existing role overseeing Staffordshire Police, the Staffordshire Commissioner became responsible for the governance of the Staffordshire Fire and Rescue Service from August 2018. However both remain separate organisations, with separate budgets, staff and governance processes.

This report will detail the treasury management strategy for Staffordshire Police only; a separate report will follow for the Staffordshire Fire and Rescue Service. When reference is made to the Commissioner as part of this report, this represents his Staffordshire Police role only.

Recommendations

a) That the proposed borrowing strategy for the 2019/20 financial year is noted. The main features are: -

- to continue with the use of cash as far as practical, with the ability to raise long-term loans following consultation with the Director of Finance and the Commissioner;
- a forward borrowing strategy that will not be used; and
- a loan restructuring strategy that is potentially unlimited where this rebalances risk.

b) That in accordance with the MHCLG's Guidance on Local Authority Investments, the Panel note that the Annual Investment Strategy (AIS) 2019/20 has been adopted by the Commissioner as set out in Section 6 of this report and detailed in Appendix 3.

c) That the following policies are noted: -

- reviewing the strategy;
- the use of external advisors; and
- training.

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1. **Introduction**

1.1 This report outlines the Policing Treasury Management Strategy for 2019/20.

1.2 Treasury management comprises the management of the cash flows, borrowings and investments, and their associated risks. The Commissioner is exposed to financial risks, including the effects on revenue from changing interest rates on borrowings and investments, and the risks of a potential loss of invested funds. Therefore it is essential that the Commissioner successfully identifies, monitors and controls financial risk as part of prudent financial management.

1.3 The Commissioner conducts his treasury risk management within the framework of the Chartered Institute of Public Finance and Accountancy's (CIPFA) revised Treasury Management in the Public Services Code of Practice (the CIPFA Code), published in December 2017. The CIPFA Code requires that the Commissioner approves a treasury management strategy before the start of each financial year. In addition, this report fulfils the legal obligation to have regard to the CIPFA Code under the Local Government Act 2003.

1.4 The Annual Investment Strategy (AIS) for 2019/20 meets the requirements of the statutory guidance issued by the Ministry of Housing, Communities and Local Government's (MHCLG) in its revised *Guidance on Local Government Investments* published in February 2018.

1.5 CIPFA's revised *Prudential Code for Capital Finance in Local Authorities* introduced the requirement for a new capital strategy report; this is a separate report and will give a high level overview of how capital expenditure, capital financing and treasury management contribute to the provision of services, with an overview of how risk is managed and implications for future financial sustainability.

1.6 This strategy has been prepared in conjunction with the Treasury and Pensions team at Staffordshire County Council (SCC), and after consultation with the Director of Finance of the Commissioner.

2. Economic background

2.1 The UK's progress in negotiating an exit from the European Union (EU), together with any future trading arrangements, will continue to be a major influence on the County Council's treasury management strategy for 2019/20. The Office for Budget Responsibility (OBR), the government's independent official forecaster, warned of the risks of the UK economy going into recession if a Brexit deal is not negotiated with the EU.

2.2 However, the OBR's current UK growth forecasts are based on achieving an orderly withdrawal process; in October 2018, it predicted that the UK economy will grow by 1.6% in 2019, an improvement on the 1.3% it had projected in March 2019. The improved forecasts coincided with October's autumn budget statement that saw Chancellor Philip Hammond announce a fiscal giveaway of close to £15 billion for 2019.

2.3 In August 2018, expectations for inflation caused the Bank of England's Monetary Policy Committee (MPC) to vote unanimously for a rate rise of 0.25%, taking Bank Rate to 0.75%. UK Consumer Price Inflation did fall back to 2.4% in September 2018 from 2.7% in August, although higher import and energy prices continued to hold inflation above the BoE target of 2%. The November Inflation Report showed that further interest rate increases may be required to bring inflation down to the 2% target over the forecast horizon.

2.4 The US economy has continued to perform well, and the Federal Reserve has maintained its monetary tightening stance and pushed up its target range for the Fed Funds Rate in December 2018 by 0.25% to 2.25% - 2.5%. It is expected that there will be a further two rises in 2019. However, there is a risk that the US-China trade war, combined with a continued tightening of monetary policy, may contribute to a slowdown in global economic activity in 2019.

2.5 Although Europe experienced slower growth in 2018, the European Central Bank has started conditioning markets for the end of quantitative easing as well as the timing of the first interest rate hike. This is currently expected in 2019, with the timing and magnitude of further rate increases thereafter.

2.6 Due to the risks of financial market volatility, the treasury strategy retains the low risk approach adopted in recent years, based on prioritising security, liquidity and then yield.

3. Interest rates

3.1 In terms of treasury management, the Bank Rate is fundamental to the income received and it may also affect expenditure on loan interest where new loans are taken out or variable rate loans are held.

3.2 The County Council has forecast two more Bank Rate hikes of 0.25% during 2019, to take official UK interest rates to 1.25%. The Bank of England's MPC continues to have a bias towards tighter monetary policy although it is has maintained further rate rises would be gradual and to a limited extent. Some commentators believe that MPC members consider cutting Bank Rate from a higher level would be a more effective policy if some of the Brexit risks transpire.

3.3 The UK economic environment remains uncertain, primarily because the economy faces a challenging outlook as it exits the EU. At the time of writing in late November, Prime Minister May had reached an agreement with the EU on transition and on future relations, that had been backed by her Cabinet. However, the deal would still need to be approved by UK and EU parliament with the possibility of a "no deal" Brexit still hanging over economic activity. As such, the risks to the interest rate forecast are considered firmly to the downside.

3.4 Gilt yields and hence long-term borrowing rates have remained at low levels but some upward movement from current levels is expected based on the interest rate projections, due to the strength of the US economy and the ECB's forward guidance on higher rates. 10-year and 20-year gilt yields are forecast to remain around 1.5% and 2% respectively over the interest rate forecast horizon, however volatility arising from both economic and political events are likely to continue to offer borrowing opportunities.

3.5 Interest rates in the medium term are still not expected to reach pre-crisis levels and this is important for the strategies that follow. This is because variable rate investment income will not cancel out fixed loan interest expenditure (known as the cost of carrying loans).

4. Credit outlook

4.1 The Bank Recovery and Resolution Directive (BRRD) from 2015 introduced a significant risk for local authorities. Under these rules, a failing bank will need to be 'bailed-in' by current investors instead of a 'bail out' by government. The risk of loss for local authorities in a bail-in situation is much greater, as any unsecured fixed-term deposits would be ranked near the bottom of the capital structure and would be one of the first to suffer losses.

4.2 Ring-fencing legislation adopted by UK financial regulators required the larger UK banks to separate their core retail banking activity from the rest of their business i.e. investment banking. The aim is to protect retail banking activity from unrelated risks elsewhere in the banking group, as occurred during the global financial crisis. The big four UK banking groups - Barclays, HSBC, Lloyds and NatWest/Royal Bank of Scotland - have now divided their retail and investment banking divisions into separate legal entities. Credit rating agencies have adjusted the ratings of some of these banks with the ringfenced banks generally being better rated than their non-ringfenced counterparts.

4.3 In November 2018, the Bank of England released the results of its latest stress tests on seven of the UK's largest banks and building societies. The Bank believe that the tests showed that the UK banking system is resilient to deep recessions that are more severe than the global financial crisis. The Bank did not require any bank to raise additional capital.

4.4 European banks are considering their approach to Brexit, with some looking to create new UK subsidiaries to ensure they can continue trading there. The credit strength of these new banks remains unknown, although the chance of parental support is assumed to be high if ever needed. The uncertainty caused by the protracted negotiations between the UK and EU is weighing on the creditworthiness for UK and European banks with substantial operations in both jurisdictions.

4.5 The Commissioner will work with the Treasury and Pensions team at the County Council to monitor developments on bank credit risk.

4.6 The Commissioner's full creditworthiness approach is detailed in the Authority's Annual Investment Strategy (AIS) outlined in **Section 8**. This also sets out where cash will be invested.

5. Borrowing strategy

5.1 At 31 March 2019, it is anticipated that long-term loan debt will be around 88% funded, i.e. covered by around £65m of fixed interest rate long-term loans. Around £7m is forecast to be needed to complete the borrowing reflecting the strategy of using cash to date (see table at **Paragraph 5.3**).

5.2 There are three main options in the borrowing strategy:

- to use cash (i.e. do not borrow);
- to bring borrowing up to the amount needed to fully fund the capital programme at any point in time; and
- to forward borrow up to two years in advance, as allowed in the Prudential Code.

5.3 The following table shows a forecast for the levels of debt, loans and use of cash at 31 March 2019 and for the next three years, after the use of capital receipts to fund spend.

	March 2019 £m	**March 2020 £m**	**March 2021 £m**	**March 2022 £m**
Forecast Gross Debt	75	91	92	91
Forecast Loans Position	(59)	(57)	(56)	(52)
Gap in Funding	**16**	**34**	**36**	**39**

5.4 Although forecasts are uncertain to some extent, this table shows that there is a notable increase in the level of forecast debt in the next couple of years (with the increase mainly driven by the planned investment in the IT programme). During this period loans are slowly maturing (falling due) but the gap in funding increases largely in line with the debt figures.

	2018/19 £m	2019/20 £m	2020/21 £m	2021/22 £m
Gap in Funding [1]	16	34	36	39
Forecast use of Cash (internal borrowing)	9	9	10	10
Forecast external borrowing	7	18	1	2
Forecast Loans Position	(66)	(82)	(82)	(81)

5.5 The table above shows loans are slowly maturing (falling due) over the period, but the gap in funding increases largely in line with the debt figures. The increases in the gap in funding are significant meaning that the use of cash in lieu of borrowing would not be sustainable, given the level of cash balances anticipated. The gap of funding could be supported through a combination of the use of cash and external borrowing, either temporarily through short term borrowing or more permanently through longer term borrowing.

5.6 It is important to understand that not all of the funding gap shown needs to be closed with loans; an important aspect of using some cash is its risk reduction effects:

- Using cash reduces security risk as investment balances are lower. The Government emphasises the importance of minimising this risk above all others in the regulations discussed later in this report. This is even more important to the Commissioner with the advent of bail-in risk.
- There is less exposure to variable interest rate changes; this exposure arises when a fixed term loan is taken out with corresponding variable rate investments. This is avoided when cash is used.
- The low interest rate environment allows a portion of the capital programme to be funded at low cost through the use of cash and this opportunity should continue to be maximised.

5.7 The Commissioner will monitor the benefits of internal borrowing on a regular basis as this strategy must be balanced against the possibility that long term borrowing costs may increase in future years, leading to additional costs incurred in deferring borrowing. The Commissioner will need to determine whether it borrows additional sums at long term fixed rates in 2019/20 with a view to keeping future interest costs low. To this end, the Commissioner will consult with the treasury team at Staffordshire County Council.

5.8 The strategy proposed is one that still aims to balance the liquidity needs of day to day cash management with the low risk approach that is offered by using cash. As cash balances will not be sufficient throughout the year, the

[1] The gap in funding is a cumulative figure and is funded by the in year use of cash and borrowing figures plus the previous year(s) borrowing figures.

question arises as to what loans should be raised to provide the liquidity necessary to allow the Commissioner to continue to pay its bills.

Sources of borrowing

5.9 The approved sources of long term and short term borrowing are:

- Public Works Loans Board (PWLB) and any successor body
- UK Municipal Bonds Agency Plc and any other special purpose companies created to enable local authority bond issues
- Other UK public sector bodies
- UK public pension funds
- Approved banks or building societies authorised to operate in the UK
- Any institutions approved for investments.

Short-term loans

5.10 Short-term loans raised from money markets are typically under 6 months duration. These are low cost and the Commissioner can respond flexibly to liquidity pressures by raising these when needed. The disadvantage of short-term loans is one of availability and it can be difficult to raise quickly from banks and building societies.

5.11 The local authority lending market has progressed considerably in recent years and funds are generally available in the short to medium term. However future availability cannot be predicted as loans raised depend upon other local authorities still having cash balances and being prepared to lend it to the Commissioner.

Long-term loans

5.12 Long-term loans are those for a duration of more than 12 months. The Commissioner has previously raised the majority of its long term borrowing from the PWLB, a statutory body that issues loans to local authorities. Government consent is not required hence the PWLB continues to be seen as the 'lender of first resort' because of the flexibility and ease of access. However local authorities are required by law to have regard to the Prudential Code and only borrow within relevant legislation and its borrowing powers.

5.13 In November 2016 the Government announced plans to transfer the powers of the PWLB to the Treasury. It is important to note that the reforms have had no real effect on the County Council's existing PWLB loans or on local authority lending policy from Central Government.

5.14 The exact type of loan to be raised by the Commissioner and its duration would have to be considered at the time; but with current interest rates and the maturity profile of the existing loan portfolio, loans towards the shorter end of the yield curve offer better value for money.

5.15 The optimum timing for borrowing cannot be foreseen and decisions often need to be taken at short notice. Because of this, it is proposed to delegate the decision to borrow long-term loans to the Director of Finance at the Commissioner, and reported retrospectively to the Finance Panel and the ETA Panel. In addition the outturn and half-year reports will update the position later in the year.

5.16 The overall strategy of maximising the use of cash in lieu of borrowing is still considered a relatively low risk strategy, although it is impossible to eliminate all treasury risk. The consequences of using cash are the possibility of increased costs in the future if interest rates rise; this must be balanced with the extra cost now if loans are raised (the cost of carry).

Loan restructuring

5.17 Movements in interest rates over time may provide opportunities to restructure the loan portfolio in one of two ways:

- Replace existing loans with new loans at a lower rate (known as loan rescheduling).
- Repay loans early, without replacing the loans. As this would increase the use of cash this is no longer a viable option with the debt levels outlined earlier.

5.18 Currently loan restructuring would be very expensive and unattractive for the Commissioner. This is because:

- gilt yields are still historically low. This would lead to large penalties to compensate the PWLB or its successor body if loans were repaid early; and
- new loans are much more expensive than in the past even though gilt yields are so low. Since 2010 the Government has increased the margin on top of gilts at which it onward lends to local government via the PWLB or its successor body (now 0.80%).

5.19 Market conditions and regulations can change and the outcome cannot be foreseen. It is therefore proposed to allow unlimited loan restructuring with the decision being delegated to the Director of Finance at the Commissioner, and reported retrospectively to the Finance Panel and the ETA Panel.

Policy on borrowing in advance of need

5.20 The Prudential Code allows borrowing to take place for more than or in advance of needs, as long as local authorities are not solely seeking profits from the investment of the extra sums borrowed. Government regulations state that there should be a specific policy on borrowing in advance of need.

5.21 As the borrowing strategy proposed for 2019/20 involves maximising the use of cash until borrowing is required, the policy is not to borrow in advance this year. This will be revisited annually as part of the overall borrowing strategy.

6. **Annual Investment Strategy (AIS) 2019/20**

MiFID II

6.1 Following the introduction of the second Markets in Financial Instruments Directive (MiFID II) regulations from January 2018, local authorities will automatically be treated as retail clients by financial services firms, unless they 'opt up' to be professional clients. As a retail client, local authorities would receive enhanced protections but this would also mean they may face restricted access to certain products including money market funds (MMF's), pooled funds, treasury bills and treasury advice.

6.2 For 2019/20, the Commissioner are not expected to meet the criteria to opt up to be a professional client (in particular, the criteria to have investment balances over £10 million) and will continue to be treated as a retail client by financial firms.

6.3 Following the introduction of MiFID II, the Federated MMF confirmed it would no longer service retail clients. As a result the Commissioner closed their account with Federated and opened a new MMF with State Street in 2018/19. MMFs held by the Commissioner with Morgan Stanley and Aberdeen Standard will continue to service retail clients.

Investment options

6.4 The PCC manages a portfolio that reached a high of over £42m in 2018/19; however the average daily balance over the financial year is only expected to be about £9.6m. Since the financial crisis the Commissioner has taken a low risk approach to investment and the AIS continues in this vein.

6.5 The CIPFA Code requires the Commissioner to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Commissioner's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income.

6.6 If the UK enters into a recession in 2019/20, there is a small chance that the Bank of England could set its Bank Rate at or below zero, which is likely to feed through to negative interest rates on all low risk, short-term investment options. This situation already exists in many other European countries. In this event, security will be measured as receiving the contractually agreed amount at maturity, even though this may be less than the amount originally invested.

6.7 The main investment options to consider are related to:

- the credit risk of investment counterparties
- the length of the investment
- the type of financial instrument that are used.

6.8 The type of financial instruments that can be used can be divided into ‘specified’ investments and ‘non-specified’ investments.

Specified investments

6.9 Specified investments are investments made in sterling for a period of less than a year that are not counted as capital expenditure and are invested with:

- the UK Government;
- a UK local authority, parish council or community council; or
- a body or investment instrument that has ‘high credit quality’.

6.10 The first two named investments are not subject to “bail-in” risk as mentioned in **paragraph 6.1** in this report. The assessment of the third aspect of high credit quality is dealt with in the paragraphs that follow.

The Credit Management Strategy for 2019/20

6.11 Government guidance requires an explanation of how credit quality is monitored, what happens when it changes and what additional sources of information are used to assess credit quality.

6.12 In the past a broad list of banks and building societies were utilised; however, over time the number of approved banks and building societies has fallen away because of poor returns relative to the risk of investing. The anticipated position for 2019/20 is that only one bank will be used, Lloyds Bank Plc, and this will be in the context of their banking relationship with the Commissioner.

6.13 As with any bank, the credit environment will be monitored to make a subjective judgement on the creditworthiness of Lloyds, this includes:

- credit ratings from the three main credit rating agencies;
- Credit Default Swaps (CDS) (i.e. the cost of insuring against counterparty default);
- share price and bond yields;
- balance sheet structure;
- macro-economic factors; and
- potential government support.

6.14 The Commissioner remains responsible for all its investment decisions. The Treasury and Pensions team at the County Council will have treasury management meetings with the Commissioner on a quarterly basis where a review of the Lending List will take place.

6.15 Under stressed market conditions, additional meetings with the County Council’s Treasury and Pensions team may take place at very short notice. A decision may be made to adjust the Commissioner’s investment risk profile; the end result may involve moving investments to lower risk counterparties or instruments.

Money Market Funds

6.16 Money Market Funds (MMF's) are pooled investment vehicles consisting of money market deposits and similar instruments. MMF's are used by the Commissioner currently and more widely by other public and private sector bodies.

6.17 Existing MMFs are expected to be compliant to new EU regulations by January 2019. As part of the reforms, most short term MMF's will convert from a Constant Net Asset Value (CNAV) to a Low Volatility Net Asset Value (LVNAV) structure.

6.18 The assets of LVNAV MMF's are marked to market, meaning the dealing NAV (unit price) may fluctuate. However MMF's will be allowed to maintain a constant dealing NAV provided they meet strict new criteria and minimum liquidity requirements. Public debt CNAV MMF's will still be available where 99.5% of assets are invested in government debt instruments.

6.19 MMF's proposed for use would be 'AAA' rated, the highest possible credit rating, and they would have the following attributes:

- Diversified – MMF's are diversified across many different investments, far more than could be achieved individually.
- Same day liquidity – this means that funds can be accessed on a daily basis.
- Ring-fenced assets – the investments are owned by the investors and not the fund management company.
- Custodian – the investments are managed by an independent bank known as a custodian, who operates at arms-length from the fund management company.

6.20 All treasury activity carries an element of risk and MMF's are no different. In the event of a further financial crisis, the failure of one or more of an MMF's investments could lead to a run on the MMF as investors rush to redeem their investment. This could then spread to other MMF's as investors take flight from this asset class. The new MMF regulations look to limit some of these risks.

6.21 The very low interest rate environment also threatens the ongoing continuity of MMF's. Each MMF charges a fee and this could mean that interest earned became negative after its deduction. If this problem arose then it would be a matter of moving funds to an alternative class of investment. However this threat has receded to some degree with the recent rise in Bank Rate.

6.22 All of these issues point towards the fundamental need for diversification across investment categories. This issue is dealt with later in this report (see **paragraph 8.28**).

Banking

6.23 The PCC's banking provider is Lloyds Bank. Funds are retained with Lloyds Bank each night earning interest at a market rate; the amount retained will be set in line with the diversification policy set out at **paragraph 8.29.**

6.24 In respect of the Bank ring-fencing legislation referred to in **paragraph 6.2**, Lloyds Bank has a relatively small investment banking operation meaning that 97% of the bank's assets remained within the 'retail' ring-fence. The Commissioner's business with Lloyds Bank will take place within the 'retail' ring-fence (Lloyds Bank Plc) and not form part of their investment banking operations (Lloyds Bank Corporate Markets).

6.25 Long term credit rating issued by the three major agencies indicate there have been upgrades for some ringfenced 'retail' banks and downgrades for some non-ringfenced 'investment' banks. Lloyds Bank Plc has seen a credit ratings upgrade; should the Lloyds credit rating fall, then small balances may be retained with the bank for operational efficiency. The Commissioner will continue to seek information on any developments from the Treasury team at the County Council with a course of action to be determined by the Director of Finance at the Commissioner.

Investment duration

6.26 The specified investments set out in this report are of short duration. Funds invested with banks, either through a MMF or the Commissioner's banker, are liquid and available at same day notice. Other regulation investments may be invested for up to 12 months.

6.27 The current lending list is shown at **Appendix 3**. The maximum recommended investment duration for 2019/20 works within the definition of a specified investment, which is to not invest for more than a year.

Investment diversification

6.28 Having determined the list of highly rated counterparties and the duration of investments, the last piece of the process is to overlay the methodology for ensuring diversification. Ensuring diversification is important as it protects the security of the investments by limiting loss in the event of a counterparty default. However, diversification does not provide protection from a systemic failure of the banking sector, although the risk of this has diminished as a result of bail-in banking regulations.

6.29 Financial limits force investments to be spread.

- For regulation investments (the least risk of all) there is no limit. All investments could be placed here.
- For MMF's a limit is in place in order to meet liquidity requirements; £1.5m per MMF.
- For Lloyds Bank a limit is set that minimises processing costs and also provides a small amount of additional liquidity; £0.5m.

6.30 Where cash balances are very low then this may mean that all investments are placed with the MMF’s and Lloyds Bank. However, balances will be within the limits stated above.

6.31 It is proposed that both the application and amendment of this policy are delegated to the Director of Finance at the Commissioner with the outcome reported in the regular treasury management reports to the Finance Panel and the ETA Panel.

Non-specified investments

6.32 Government regulations define non-specified investments as all other types of investment that do not meet the definition of specified investments. In contrast to specified investments, Government guidance indicates that the AIS should:

- set out procedures for determining which categories of Non-specified investments should be prudently used;
- identify such investments;
- state an upper limit for each category of non-specified investment; and
- state upper limits for the total amount to be held in such investments.

6.33 Currently, non-specified investments are not in use due to lower cash balances and the potential for increased risk.

Non-treasury investments

6.34 Under the revised CIPFA Codes and MHCLG Guidance, local authorities may invest in other financial assets and property for financial return, and also make loans and investments for service purposes.

6.35 The revised CIPFA Code and MHCLG Guidance require such non-treasury investments to be assessed as part of the new capital strategy and investment strategy. They should set out the specific policies and arrangements for non-treasury investments and ensure the same robust procedures for the consideration of risk and return are applied to these, as for treasury investments.

6.36 Under the new CIPFA Codes, the Commissioner should also maintain a schedule setting out a summary of its non-treasury investments. The Commissioner does not currently hold any non-treasury investments.

Risk

6.37 Although guidance sets out security and liquidity as being the main treasury risks, they are not the only investment risks faced by the Commissioner. **Appendix 4** sets out a high-level risk assessment for six of the key risks which are summarised in the following table:

Risk	**Assessment**
Security	Low
Liquidity	Low to Medium
Interest rate	Low to Medium
Market	Low
Refinancing	Low to Medium
Regulatory and legal	Low

6.38 Within the PCC's AIS there is a balance to be struck between the security of investments and liquidity; the safest investments are not necessarily the most liquid and so a pragmatic approach must be taken.

6.39 The proposed AIS has been evaluated against these risks and the judgement is that the most significant risks have been reduced as far as possible. This is not to say that all risk has been eliminated which is not possible in treasury terms.

Review of strategy

6.40 Regulations require that the circumstances under which a revised strategy would be prepared should be stated. These circumstances would be a change in:

- the economic environment;
- the financial risk environment;
- the budgetary position; or
- the regulatory environment.

6.41 The responsibility for assessing these circumstances and proposing changes to the strategy is allocated to the Director of Finance at the Commissioner.

Policy on the use of external service providers

6.42 Regulations require that the policy on the use of external providers is disclosed. Currently the Commissioner has no contracted external treasury adviser and this is considered appropriate with the simple arrangements set out.

6.43 The treasury service to the Commissioner is provided by the Treasury team at Staffordshire County Council, who use Arlingclose as their external treasury management adviser. The County Council's contract with Arlingclose was renewed in 2017 following a tender process. The Commissioner could use Arlingclose to provide consultancy advice on an ad-hoc basis should this be considered necessary.

Investment management training

6.44 Regulations require disclosure of the processes for ensuring officers are well trained in investment management. Treasury management is a specialised area requiring high quality and well trained staff with an up to date knowledge of current issues, legislation and treasury risk management techniques.

6.45 The Treasury team at the County Council who provide the treasury service are experienced and attend regular CIPFA and treasury consultant training seminars throughout the year.

6.46 Training needs for the Commissioner's staff who attend quarterly meetings with the Treasury and Pensions team at the County Council are assessed on an ongoing basis by local managers.

SCC Memorandum of Understanding

6.47 Staffordshire County Council provides treasury management and banking services as part of a Memorandum of Understanding (MOU) with the Commissioner. The MOU does not constitute a formal contract but is a document of good practice; it outlines the range of services provided by the Council and the degree of co-operation required from the Commissioner in order for the Council to fulfil its role.

Background Documents:

1. Treasury Management in the Public Services: Code of Practice (CIPFA) (2017)
2. The Prudential Code for Capital Finance in Local Authorities (CIPFA) (2017)
3. The Local Authorities (Capital Finance and Accounting) (England) Regulations 2003
4. Statutory Guidance on Local Government Investments – Issued under Section 15(1) (a) of the Local Government Act 2003 (2018)
5. Statutory Guidance on Minimum Revenue Provision – Issued under section 21 (1A) of the Local Government Act 2003 (2018)

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Treasury Management Indicators

Indicator	**Estimate 2019/20**	**Estimate 2020/21**	**Estimate 2021/22**
1. Interest rate exposures			
a. Upper limit (fixed)	£90m	£91m	£90m
b. Upper limit (variable)	(£30m)	(£30m)	(£30m)
Upper limits of fixed and variable borrowing and investments are required to be set. This limits exposure to both fixed and variable interest rate movements as part of the overall risk management strategy for treasury management activities. Negative figures are shown in brackets; these relate to investments at a variable rate which are not offset by variable borrowings.			
2. Maturity structure of borrowing	Upper Limit	Lower Limit	
Under 12 months	10%	0%	3.4%
12 months and within 24 months	10%	0%	1.7%
24 months and within 5 years	30%	0%	13.1%
5 years and within 10 years	50%	0%	12.5%
10 years and above	100%	25%	69.3%
This indicator identifies the amount of loans maturing in specified periods. The overarching principle is that steps should be taken from a risk management point of view to limit exposure to significant refinancing risk in any short period of time. *As a result no more than 10% of fixed rate loans are planned to mature in any one financial year.*			
3. Total principal sums invested for periods longer than a year	£	£	£
Any investments made for longer than a year will be in accordance with the limits on non-specified investments.	nil	nil	nil
4. Borrowing in advance of need (maximum debt)	100%	100%	100%
This indicator sets the maximum loans as a proportion of the borrowing need. In 2019/20 the strategy is not to borrow in advance, hence the indicator is set at 100%.			

Appendix 2

Policing Treasury Management Strategy Report 2019/20

Risk assessment – Borrowing strategy

Risk	Risk description	Relevance to borrowing	Key control	Assessment	Borrowing strategy
Security	A third party fails to meet its contractual obligations (i.e. counter party risk).	Unlikely there would be a failure between the agreement to borrow and sums being received. Exposure to investment risk if borrow in advance and invested until needed.	Usually borrow from the Government (PWLB or its successor body) with 2 day gap between agreement to borrow and receipt of money.	**LOW**	Use of cash to fund debt reduces this risk. There is insufficient cash to fully fund debt so it is likely that borrowing will be required.
Liquidity	Cash is not readily available when it is needed.	Usually borrow for capital from Government (PWLB or its successor body). Can also borrow for the short-term e.g. from other local authorities.	Prudential rules on borrowing and consideration of whether Government is secure.	**LOW to MEDIUM**	Use of cash to fund debt increases this risk as liquidity is reduced when borrowing is avoided. Any increase in borrowing decreases this risk.
Interest rate	Unexpected reduction in short term interest rates.	Depends on the mix between fixed and variable rate borrowing. Higher exposure to variable rate borrowing helps the budget.	The control is set out below.	**LOW to MEDIUM**	Pursuing a strategy of using cash reduces the overall net exposure to sudden interest rate falls.
Interest rate	Unexpected increase in short term interest rates.	Depends on the mix between fixed and variable rate borrowing. Lower exposure to variable rate borrowing helps the budget.	Limit variable rate borrowing to a relatively small proportion (e.g. 20%).	**LOW to MEDIUM**	20% limit provides a suitable risk control.

Risk	Risk description	Relevance to borrowing	Key control	Assessment	Borrowing strategy
Market	The market value of loans change substantially (i.e. how much is the borrowing strategy exposed to long term interest rate change).	How much risk is built into the maturity profile of the loans structure.	This is inversely linked to refinancing risk below.	**MEDIUM**	Use of cash will shorten the duration of the loan portfolio and reduces this risk. Without the use of cash this risk assessment would probably be high.
Refinancing risk	Maturing transactions cannot be renewed on similar terms.	To avoid a high level of borrowing over a short period with exposure to high interest rates.	The Commissioner has a policy of limiting maturing loans to 10% of the loans portfolio.	**MEDIUM**	Using cash to fund debt potentially increases the refinancing risk. Without the use of cash this risk assessment would probably be low.
Regulatory and legal risk	Rules governing local government borrowing are changed or amended without notice, which has happened in the recent past.	Local government heavily reliant upon PWLB or its successor body. Cost and ability to reschedule / manage loans are determined by the Government. The Government could close the PWLB or is successor body and force local authorities to use market loans for all new borrowing.	Market loans will be evaluated and will be taken if they are good overall value.	**MEDIUM**	Use of cash means that PWLB (or its successor body) loans may not be taken. However there is insufficient cash to fully fund debt in the medium term so it is likely that borrowing will be required. If the PWLB or its successor body was closed to new business then other loans would have to be taken.

Appendix 3

Policing Treasury Management Strategy Report 2019/20

Lending List – December 2018	
	Time Limit
Regulation Investments	
UK Government DMADF account	6 months
UK Local Authority	12 months
Bank	
Lloyds (as banker) (£0.5m maximum)	call only
MMF's	
State Street (£1.5m maximum)	call only
Morgan Stanley (£1.5m maximum)	call only
Aberdeen Standard (£1.5m maximum)	call only

Appendix 4

Policing Treasury Management Strategy Report 2019/20

Risk assessment - Investments

Risk	Risk description	Relevance to investment	Key control	Assessment	Approved Investment Strategy (AIS)
Security	A third party fails to meet its contractual obligations (i.e. counter party risk).	Crucial that money invested is returned (principal and interest).	Relies on credit management policy including; credit risk, duration of investment and amount as well as an ongoing review of the credit environment. Prudential limit on investment over 1 year.	**LOW**	Use of the investments identified within the AIS reduces this risk to a low level. The borrowing strategy identified will reduce cash balances and the resulting security risk. With the exception of regulation investments, counterparties also have a financial limit to ensure funds are spread amongst them. Overall this remains a low risk strategy.
Liquidity	Cash is not readily available when it is needed.	Need to plan investment to match cash requirements.	Managed through detailed cash flow forecast and investments in highly liquid funds.	**LOW to MEDIUM**	Same day access accounts are held with three MMF's. Balances are held with Lloyds Bank Plc overnight on account. Cash flow plans are completed annually and regularly updated.
Interest rate	Unexpected <u>reduction</u> in Interest rate.	Reduces the return on investment and reduces the level of reserves.	Can reduce risk by; A) netting off investment against borrowing to reduce net exposure B) investing for longer periods.	**LOW**	Investments will be mainly short term – this does not protect against an interest rate reduction. Although interest rates are expected to rise, interest rates are still at historically low levels.

Risk	Risk description	Relevance to investment	Key control	Assessment	Approved Investment Strategy (AIS)
Interest rate	Unexpected increase in interest rates.	To take advantage of the unexpected return, would need to keep investment short term and increase the amount of cash invested (e.g. by not using cash in lieu of borrowing).	Controlled through the overall strategy.	**MEDIUM**	Current policy allows upturns to be taken advantage of as investments are not fixed for long periods. Using cash to fund debt (the proposed borrowing strategy) reduces this risk as the overall exposure to short term interest rates is less.
Market	Unexpected need to liquidate market instrument quickly and accept 'price on the day'.	Only relevant if invest in market instruments (e.g. CD's, gilts).	Limit investment in market instruments or alternatively have capacity to borrow to avoid need to liquidate. Controlled by limits on non specified investments.	**LOW**	Market instruments are not in use.
Refinancing risk	Maturing transactions cannot be renewed on similar terms.	Reflected in the term (duration) of investments. Shorter term investments have a higher refinancing risk.	Proportion of investments maturing in the short term.	**LOW to MEDIUM**	The current policy is to invest in the short term. There is an increased risk with this strategy due to frequent 'refinancing' but this is only expected to be advantageous in a rising interest rate environment. Using cash to fund debt (the proposed borrowing strategy) reduces this risk as the overall exposure to short term interest rates is less.

Appendix 4 (continued)

Risk	Risk description	Relevance to investment	Key control	Assessment	Approved Investment Strategy (AIS)
Regulatory and legal risk	Rules governing local government investment powers are changed or amended without notice.	Investment powers are granted through statute and guidance.	None.	**LOW**	The current policy of using cash in lieu of borrowing reduces the authority's dependency on interest receipts. The AIS is low risk and uses liquid and conservative investment instruments.