



Police Fire and Crime Panel

1 February 2021

TREASURY MANAGEMENT STRATEGY REPORT 2021/2022

Report of the Staffordshire Commissioner

1. **Background**

- 1.1 In addition to the 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 and governance processes.
- 1.2 This report will detail the treasury management strategy for Staffordshire Police only; a separate report has been completed for the Staffordshire Fire and Rescue Service. Therefore, reference is made only to the **Staffordshire Police and Crime Commissioner ('the Commissioner')** as part of this report.

2. **Introduction**

- 2.1 This report outlines the Commissioner's Treasury Management Strategy for 2021/22.
- 2.2 Treasury management comprises the management of the Commissioner's 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.
- 2.3 The Commissioner conducts its treasury risk management within the framework of the Chartered Institute of Public Finance and Accountancy's (CIPFA) *Treasury Management in the Public Services Code of Practice 2017 Edition* (the CIPFA Code). 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.
- 2.4 The Annual Investment Strategy (AIS) for 2022/22 meets the requirements of the statutory guidance issued by the Ministry of Housing, Communities and Local

Government's (MHCLG) in its *Guidance on Local Government Investments 2018 Edition*.

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

3. **Summary recommendations**

- 3.1 The Police Fire and Crime Panel to note the proposed borrowing strategy for the 2021/22 financial year. 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 at the Commissioner; and
 - a loan restructuring strategy that is potentially unlimited where this rebalances risk.
- 3.2 The Police Fire and Crime Panel to note in accordance with the MHCLG's Guidance on Local Authority Investments, the adoption of the Annual Investment Strategy (AIS) 2021/22 as detailed in **Section 7** of this report and summarised in **Appendix 3**. Also, to note the policies on:
- reviewing the strategy;
 - use of external advisors; and
 - training.

4. **External Context**

Economic background

- 4.1 The impact on the UK from coronavirus, together with the exit from the European Union and future trading arrangements with the bloc, will remain a major influence on the County Council's treasury management strategy for 2021/22.
- 4.2 The Bank of England (BoE) maintained Bank Rate at 0.10% in November 2020 and also extended its Quantitative Easing programme by £150 billion to £895 billion. The Monetary Policy Committee voted unanimously for both, but no mention was made of the potential future use of negative interest rates.
- 4.3 UK Consumer Price Inflation (CPI) for November 2020 registered 0.3% year on year, down from 0.7% in the previous month. Core inflation, which excludes the more volatile components, fell to 1.1% from 1.5%. The most recent labour market data for the three months to October 2020 showed the unemployment rate rose to 4.9% while the employment rate fell to 75.2%. Both measures are expected to deteriorate further due to the ongoing impact of coronavirus on the jobs market, particularly when the various government job retention schemes start to be unwound in 2021, with the BoE forecasting unemployment will peak at 7.75% in Q2 2021. In October, the headline 3-month average annual growth rate for wages were 2.7% for total pay and 2.8% for regular pay. In real terms, after adjusting for inflation, total pay growth was up by 1.9% while regular pay was up 2.1%.

- 4.4 GDP growth rebounded by 16.0% in Q3 2020 having fallen by -18.8% in the second quarter, with the annual rate rising to -8.6% from -20.8%. All sectors rose quarter-on-quarter, with dramatic gains in construction (41.2%), followed by services and production (both 14.7%). Monthly GDP estimates have shown the economic recovery slowing and remains well below its pre-pandemic peak. Looking ahead, the BoE's November MPR forecasts economic growth will rise in 2021 with GDP reaching 11% in Q4 2021, 3.1% in Q4 2022 and 1.6% in Q4 2023.
- 4.5 GDP growth in the euro zone rebounded by 12.7% in Q3 2020 after contracting by -3.7% and -11.8% in the first and second quarters, respectively. Headline inflation, however, remains extremely weak, registering -0.3% year-on-year in October, the third successive month of deflation. Core inflation registered 0.2% y/y, well below the European Central Bank's (ECB) target of 'below, but close to 2%'. The ECB is expected to continue holding its main interest rate of 0.0% and deposit facility rate of -0.5% for some time.
- 4.6 The US economy contracted at an annualised rate of 31.7% in Q2 2020 and then rebounded by 33.1% in Q3. The Federal Reserve maintained the Fed Funds rate at between 0.0% and 0.25% and announced a change to its inflation targeting regime to a more flexible form of average targeting. The Fed also provided strong indications that interest rates are unlikely to change from current levels over the next three years.

Credit outlook

- 4.7 After spiking in late March as coronavirus became a global pandemic, credit default swap (CDS) prices for the larger UK banks have steadily fallen back to almost pre-pandemic levels. Although uncertainly around coronavirus related loan defaults led to banks provisioning billions for potential losses in the first half of 2020, drastically reducing profits; reported impairments for Q3 were much reduced in some institutions. However, general bank profitability in 2020 is likely to be significantly lower than in previous years.
- 4.8 The credit ratings for many UK institutions were downgraded on the back of downgrades to the UK sovereign rating. Credit conditions more generally though in banks and building societies have tended to be relatively benign, despite the impact of the pandemic.
- 4.9 Looking forward, the potential for bank losses could be greater than expected when government and central bank support starts to be removed remains a risk, suggesting a cautious approach to bank deposits in 2021/22 remains advisable.

Interest rate forecast

- 4.10 The County Council's Treasury Adviser, Arlingclose is forecasting that BoE Bank Rate will remain at 0.1% until at least the end of 2023. The risks to this forecast are judged to be to the downside as the BoE and UK government continue to react to the coronavirus pandemic and the Brexit transition period ends. The BoE extended its asset purchase programme to £895 billion in November 2020 while keeping Bank Rate on hold. However, further interest rate cuts to zero, or possibly negative, cannot yet be ruled out but this is not part of the County Council forecast.

- 4.11 Gilt yields are expected to remain very low in the medium-term while short-term yields are likely to remain below or at zero until such time as the BoE expressly rules out the chance of negative interest rates or growth/inflation prospects improve. The central case is for 10-year and 20-year Gilts to rise to around 0.5% and 0.75% respectively over the time horizon. The risks around the Gilt yield forecasts are judged to be broadly balanced between upside and downside risks, but there will almost certainly be short-term volatility due to economic and political uncertainty and events.
- 4.12 Due to the ongoing risks associated with coronavirus, the treasury strategy retains the low risk approach adopted in recent years, based on prioritising security, liquidity and then yield.

5. Local Context

- 5.1 On 30 November 2020, the Commissioner held £70.8m of external borrowing and had £29.9m temporarily invested. The Commissioner's future requirements for borrowing and investments can be considered by reviewing its balance sheet forecasts.

Balance sheet

- 5.2 In terms of borrowing, the Commissioner discloses its Capital Financing Requirement (CFR) as part of its Statement of Accounts. This represents the underlying need to borrow for capital purposes i.e. the amounts that have been financed through external and internal borrowing rather than being permanently financed.
- 5.3 If the Commissioner increases debt to fund additional capital expenditure, this will increase its Loans CFR; conversely repaying debt through the Minimum Revenue Provision (MRP) will reduce its Loans CFR. The table below shows forecasts for the Commissioner's Loans CFR and how this will be financed through external and internal borrowing:

	31.03.20 Actual £m	31.03.21 Estimate £m	31.03.22 Forecast £m	31.03.23 Forecast £m	31.03.24 Forecast £m
Loans CFR	81.0	92.9	94.8	103.8	114.6
Less: External borrowing	(71.8)	(70.8)	(67.2)	(64.7)	(63.1)
Less: Capital financing from reserves	(4.2)	(7.0)	(4.5)	(4.1)	(4.0)
Internal / (over) borrowing	5.0	15.1	23.1	35.0	47.5

- 5.4 The table above shows that the Commissioner's Loans CFR is due to increase over the period of the TMSS due to the level of the capital programme. This will mean that despite using reserves for some of its capital financing, the Commissioner's internal borrowing requirements will increase to unsustainable levels, and further external borrowing will be required. A number of existing external loans also mature during the period, further increasing the internal borrowing requirement.

5.5 CIPFA’s Prudential Code for Capital Finance in Local Authorities recommends that the Commissioner’s total external borrowing should be lower than its highest forecast CFR over the next three years; the previous table shows the Commissioner will comply with this recommendation in this period.

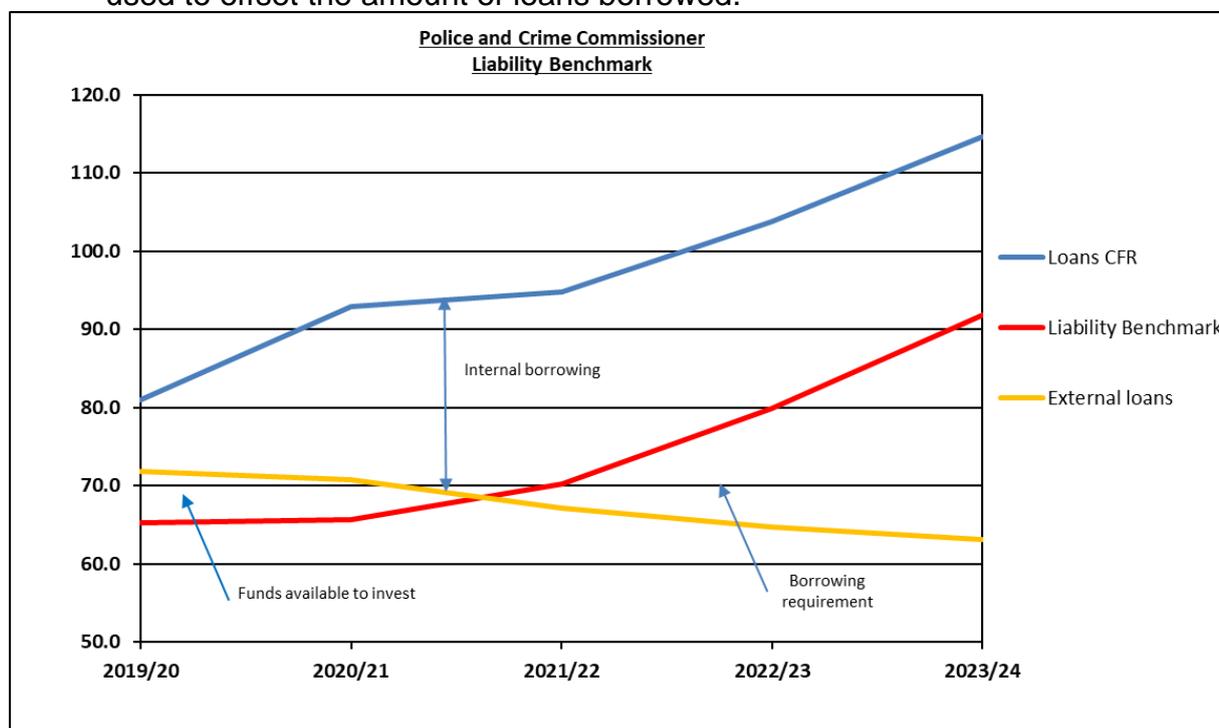
5.6 For investments, the Commissioner’s total resources available are measured by its usable reserves and working capital less any amounts that have been internally borrowed. This is shown in the following table:

	31.03.20 Actual £m	31.03.21 Estimate £m	31.03.22 Forecast £m	31.03.23 Forecast £m	31.03.24 Forecast £m
Usable reserves	16.5	20.3	20.0	19.7	18.8
Working capital surplus	0.0	0.0	0.0	0.0	0.0
(Less Internal) / Add Over Borrowing	5.0	15.1	23.1	35.0	47.5
Investments/ (New borrowing)	11.5	5.1	(3.1)	(15.2)	(28.7)

5.7 This demonstrates the Commissioner’s recent strategy in using internal borrowing to reduce the need for external borrowing and as a result, temporary investment levels. However, this strategy will not be sustainable as the Commissioner will not have sufficient internal resources to cover the internal borrowing requirement going forward and will need to borrow from external sources.

Liability benchmark

5.8 The CIPFA Prudential Code encourages local authorities to develop their own liability benchmark to manage treasury management risk. The liability benchmark represents the minimum amount of loans required to maintain cash balances at nil i.e. when all usable reserves and working capital surpluses are used to offset the amount of loans borrowed.



- 5.9 The chart shows that the Commissioner's Loans CFR (blue line) has been financed through a combination of external borrowing (yellow line) and internal borrowing (the difference between the yellow line and the blue line).
- 5.10 The chart indicates that from 2020/21, the Commissioner's level of external loans falls below the minimum required by the liability benchmark and this gap continues to widen over the period. This is because the Commissioner's Loans CFR, and hence its liability benchmark, increases throughout the period covered by the TMSS, driven by its capital investment. At the same time, the Commissioner's level of external loans fall during this period as a number of these loans are repaid upon maturity.
- 5.11 Given these forecasts, the Commissioner will need to borrow externally as it will not have sufficient usable reserves and working capital to cover the amounts required internally. Therefore, the liability benchmark will have an impact on the Commissioner's borrowing strategy for 2021/22.

6. **Borrowing strategy 2021/22**

- 6.1 The Commissioner will hold £70.8m in external loans at the beginning of 2021/22 if no other loans are taken as part of its strategy for funding previous years capital programmes. The Commissioner will need to ensure total amounts borrowed do not exceed the authorised limit of £119.3 million, as disclosed in **Appendix 1**.

Objectives

- 6.2 The primary objective for the Commissioner when considering borrowing money is to strike an appropriate balance between securing low interest costs and achieving certainty of those costs over the period for which funds are required. Although relatively low interest costs may be secured for the short term, it is more difficult to predict interest costs over the long term.

Strategy

- 6.3 Given the significant cuts to public services and to local government funding, the Commissioner continues to address the key issue of affordability without compromising the long-term stability of its debt portfolio. As short-term interest rates have been lower than long term rates, it is more cost effective to use internal resources in lieu of borrowing in the short term.
- 6.4 The balance sheet analysis at **paragraph 5.2** and the liability benchmark analysis at **paragraph 5.6** both indicate the Commissioner will not have sufficient internal resources for use in lieu of borrowing and will need to borrow externally.
- 6.5 It is important to understand that not all of the borrowing requirement 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. Regulations emphasise the importance of minimising this risk and is discussed later in this report. This is 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.

6.6 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 2021/22 with a view to keeping future interest costs low. To this end, the Commissioner will consult with the treasury team at Staffordshire County Council.

6.7 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 in the year, the 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

- 6.8 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

6.9 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.

6.10 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

6.11 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.

- 6.12 Where the Commissioner has a long-term borrowing need, it can consider the alternative sources of borrowing other than the PWLB highlighted in **paragraph 6.8**. Seeking lower interest costs may introduce greater administrative and resource costs as well as increased risk and this would need to be balanced against the ease of access to loans from the PWLB.
- 6.13 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.
- 6.14 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 Staffordshire Police, Fire and Crime Panel. In addition, the outturn and half-year reports will update the position later in the year.
- 6.15 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

- 6.16 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.
 - Currently loan restructuring would be very expensive and unappealing for the Commissioner. This is because Gilt yields are historically low. This would lead to large penalties to compensate the PWLB or its successor body if loans were repaid early.
- 6.17 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 Strategic Governance Board.

Policy on borrowing in advance of need

- 6.18 As the borrowing strategy proposed for 2021/22 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.

7. Annual Investment Strategy (AIS) 2021/22

- 7.1 It is the Commissioner's borrowing strategy that determines its investment strategy. The current economic environment of relatively low rates favours the use of cash instead of borrowing, hence balances available for temporary investments are likely to be less. In addition, the Commissioner does not have sufficient cash to meet its capital requirements and is expected to have a borrowing need in 2021/22 (**see paragraph 5.10**).
- 7.2 Nevertheless, the Commissioner may have significant level of funds to invest at different points of the year; this usually represents income received in advance of expenditure plus balances and reserves held. In the previous financial year, the Commissioner's investment balance ranged between £1.4 million and £54.5 million.

MiFID II

- 7.3 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 MMF's, pooled funds, treasury bills and treasury advice.
- 7.4 For 2021/22, the Commissioner is not expected to meet the criteria to opt up to be a professional client (in particular the criteria to have continuous investment balances over £10 million) and will continue to be treated as a retail client by financial firms.

Objectives

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

Strategy

- 7.7 The main characteristics which should determine an investment strategy are:
- the credit risk of the counterparties invested with;
 - the length of the investment; and
 - the type of financial instrument that is used.
- 7.8 The Commissioner has taken a low risk approach to investment and the AIS for 2021/22 will continue to do so. Short term unsecured bank investments have generally provided very low returns with the increasing risk from bail-in regulations. The Commissioner will continue to concentrate its short-term investments in more secure MMFs and government investments.

- 7.9 MHCLG Guidance on Local Government Investments specifies the types of financial instruments that local authorities can invest in and the Commissioner has divided its approved treasury investments into Standard Investments and Non-standard Investments.

Standard investments

- 7.10 The Commissioner considers Standard Investments to be those made with approved counterparties that do not require further approval from the Director of Finance at the Commissioner. These investments tend to be for a period of less than a year and are those most frequently used by the Commissioner. Standard Investments can be invested with:

- UK Government – central government or local authority, parish council or community council
- short term MMFs
- bank and building society investments

i) Government

- 7.11 The Commissioner invests with central government by using its Debt Management Account Deposit Facility (DMADF) account. Funds held in the DMADF account are backed by the UK Government so they are very secure; however, returns tend to be lower than those received elsewhere.

- 7.12 The Commissioner invests in term deposits with local authorities which can provide a higher return depending on the availability of, or the need for cash in the local authority lending market. Like central government investments, local government investments are not subject to bail in risk.

- 7.13 Although investments in the local authority lending market have a low risk of insolvency, they are not completely without risk. The financial risks of a few local authorities who have issued Section 114 notices have been documented in the press; the Commissioner will continue to monitor such developments and seek information from the County Council's Treasury team where necessary.

ii) Money Market Funds (MMFs)

- 7.14 Money Market Funds have high credit quality and are pooled investment vehicles consisting of money market deposits and similar instruments. Short-term MMFs that offer same day liquidity can be used as an alternative to instant access bank accounts. The Commissioner has used same day notice MMFs for some time as they have tended to provide greater security and a higher yield than bank accounts.

- 7.15 EU regulation introduced in January 2019 has meant most same day notice MMFs have converted from a Constant Net Asset Value (CNAV) to a Low Volatility Net Asset Value (LVNAV) structure. The assets of LVNAV MMFs are marked to market, meaning the dealing NAV (unit price) may fluctuate. However, LVNAV MMFs are allowed to maintain a constant dealing NAV provided they meet strict criteria and minimum liquidity requirements. Public debt CNAV MMFs are still available where 99.5% of assets are invested in government debt instruments.

- 7.16 The Commissioner will continue to use same day notice MMFs that meet the criteria listed below. These are considered to have sufficient high credit quality to be included on the Commissioner's Approved Lending List:
- Diversified – MMFs invest across many different investments meaning they achieve more diversification than the Commissioner could achieve on its own account.
 - Short liquidity – cash can be accessed daily.
 - Ring-fenced assets – the investments are owned by 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.

- 7.17 Like all treasury instruments, MMFs do carry an element of risk:
- The failure of one or more of an MMF's investments could lead to a run on MMFs, especially during a financial crisis; however, the new MMF regulations do limit this risk to some extent.
 - If the UK enters a recession, there is a possibility that the Bank Rate could be set to **at** or below zero. This could mean interest earned from MMFs could become negative after the deduction of their fee. In this instance, the Commissioner could move funds to an alternative category of investment.

iii) Bank and building society accounts

- 7.18 The Commissioner can make investments with approved banks and building societies by using call accounts or term deposits. Investments held with banks and building societies run the risk of credit loss via a bail in, if the regulator determines that the bank is failing or likely to fail.

iv) Operational bank account

- 7.19 The Commissioner's banking provider is Lloyds Bank. Cash is 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 7.22** onwards.

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

- 7.21 Lloyds Bank Plc has seen a credit ratings upgrade since ring-fencing legislation was introduced; should the Lloyds credit rating fall, then small balances may be retained with the bank for operational efficiency. The Commissioner will continue to seek support from the County Council's Treasury team on bank credit risk and any changes will be determined by the Director of Finance at the Commissioner.

Standard Investment diversification

- 7.22 Risks to investments, such as those discussed for MMFs in **paragraph 7.17**, point towards the fundamental need for diversification across counterparties

and investment categories, where possible. Diversification can help to protect the security of investments by limiting the Commissioner's loss in the event of a counterparty default. Diversification will not protect the Commissioner from a systemic failure of the banking sector even if the risk of this has diminished following the bail-in banking regulations.

- 7.23 Diversification can be achieved by setting a maximum amount to be invested with each counterparty, to limit risk and to ensure a spread of investments.
- No limits are proposed for government investments as these may be utilised for all the Commissioner's investments in certain circumstances.
 - For MMF's a standard limit of £1.5m per MMF is in place to meet liquidity requirements.
 - For Lloyds Bank a standard limit of £0.5m is set that minimises processing costs and provides a small amount of additional liquidity.
- 7.24 During 2020/21, the Commissioner held additional balances from grant receipts from the start of the second quarter. To allow flexibility for investments, the Director of Finance at the Commissioner agreed to increase the standard limits to temporary limits of £4.0m for MMFs and £1.0m for Lloyds Bank. The Commissioner will continue to use the higher temporary limits in 2021/22 until the level of cash balances fall to allow reverting to using the standard limits.
- 7.25 Where cash balances are low then this may mean that all investments are placed with the MMFs and Lloyds Bank. However, balances will be within the limits stated above.
- 7.26 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 Strategic Governance Board (Police).

Non-Standard Investments

- 7.27 The Commissioner considers Non-Standard Investments to be all other types of approved investment counterparties that are not included as part of Standard Investments i.e. those investments that are used less frequently and may require further approval from the Director of Finance at the Commissioner.
- 7.28 The Commissioner does not currently use Non-Standard Investments due to the expectations for lower cash balances in the future and the potential for increased risk.

The Credit Management Strategy for 2021/22

- 7.29 Investments made by the Commissioner should be of 'high credit quality'. Although this can be difficult to define, credit ratings can be used as published by external credit rating agencies (the three main agencies are Moody's, Standard & Poors and Fitch). Credit ratings can be obtained from the County Council's Treasury team, where available.
- 7.30 For 2021/22, the minimum credit-rating thresholds are set at a long-term rating of 'A-' where available. Counterparties that are rated below this level are excluded. However, credit ratings are not the only aspect of how creditworthiness is assessed.

- 7.31 The following elements are also factored in when evaluating creditworthiness:
- Potential government support.
 - Credit Default Swap prices (CDS) (i.e. the cost of insuring against counterparty default).
 - Share prices and bond yields.
 - Balance sheet structure.
 - Macro-economic factors.
 - A subjective overlay, i.e. a judgement being made about whether the counterparty should be recommended or not.
- 7.32 The Commissioner remains responsible for all its investment decisions. The County Council's Treasury team will continue to have treasury management meetings with the Commissioner on a quarterly basis where a review of the Lending List will take place.
- 7.33 Under stressed market conditions, additional meetings with County Council's Treasury 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.

Non-treasury investments

- 7.34 Under the CIPFA Code 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.
- 7.35 Such non-treasury investments should be assessed as part of a separate 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.
- 7.36 In the absence of any legal powers to do so the Commissioner does not currently hold any non-treasury investments and, therefore, no additional commercial strategy is required.

Risk

- 7.37 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

- 7.38 Within the Commissioner'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.

7.39 The proposed AIS has been evaluated against these risks and 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.

8. Review of strategy

8.1 The Commissioner will prepare a revised strategy when there are significant changes to the following factors:

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

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

9. Policy on the use of external service providers

9.1 Currently the Commissioner has no contracted external treasury advisor and this is considered appropriate with the simple arrangements set out.

9.2 The treasury service for the Commissioner is provided by the County Council's Treasury team, 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. This contract is currently out to tender so a different provider may be in place during 2021/22 but the service levels provided would be, by necessity, very similar.

10. Investment management training

- 10.1 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.
- 10.2 The County Council's treasury team who provide the treasury service are experienced and qualified. The officers attend regular CIPFA and treasury consultant training seminars throughout the year as well as speaking to brokers and fund managers to further understand the market.
- 10.3 Training needs for Commissioner staff who attend quarterly meetings with the County Council's Treasury team are assessed on an ongoing basis by local managers.

11. SCC Memorandum of Understanding

- 11.1 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 County Council, and the degree of co-operation required from the Commissioner for the County Council to fulfil its role. The MOU will be reviewed during 2021/22 to ensure that it meets the requirements of the Commissioner.

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Background Documents

1. Treasury Management in the Public Services: Code of Practice (CIPFA) (2017)
2. 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)
6. Localism Act 2011 – Guidance on the General Power of Competence in sections 1 to 6.

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Treasury Management Indicators

Indicator	Estimate 2021/22	Estimate 2022/23	Estimate 2023/24
1. External debt			
a. Authorised limit	£119.3m	£117.2m	£114.9m
b. Operational boundary	£109.3m	£107.2m	£104.9m
c. External loans	£80.2m	£82.7m	£83.1m
<i>The authorised limit is the maximum level of external borrowing which should not be exceeded. It is linked to the estimated level of borrowing assumed in the capital programme.</i>			
<i>The operational boundary represents the Director of Finance's estimate of the day to day limit for treasury management activity based on the most likely i.e. prudent but not worst-case scenario.</i>			
2. Interest rate exposures			
a. Upper limit (fixed)	£95m	£104m	£115m
b. Upper limit (variable)	(£60m)	(£60m)	(£60m)
<i>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.</i>			
3. Maturity structure of borrowing	Upper Limit	Lower Limit	
Under 12 months	10%	0%	5.1%
12 months and within 24 months	10%	0%	3.5%
24 months and within 5 years	30%	0%	7.2%
5 years and within 10 years	50%	0%	21.0%
10 years and above	100%	25%	63.2%
<i>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.</i>			
<i>As a result no more than 10% of fixed rate loans are planned to mature in any one financial year.</i>			
4. Total principal sums invested for periods longer than a year	£	£	£
<i>Any investments made for longer than a year will be in accordance with the limits on non-specified investments.</i>	nil	nil	nil

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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 <u>reduction</u> 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 <u>increase</u> 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.

Appendix 2 (continued)

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 PFCC 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 its 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.

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Lending List – December 2020	
	Time Limit
<i>Regulation Investments</i>	
UK Government DMADF account	6 months
UK Local Authority	12 months
<i>Bank</i>	
Lloyds (as banker) (£0.5m hard limit)	call only
<i>MMF's</i>	
Aberdeen Standard (£1.5m hard limit)	call only
CCLA (£1.5m hard limit)	call only
Morgan Stanley (£1.5m hard limit)	call only
State Street (£1.5m hard limit)	call only

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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.

Appendix 4 (continued)

Risk	Risk description	Relevance to investment	Key control	Assessment	Approved Investment Strategy (AIS)
Interest rate	Unexpected <u>increase</u> 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.