DORSET POLICE & CRIME COMMISSIONER

TREASURY MANAGEMENT & INVESTMENT STRATEGY

2020/21

1.0 Introduction

1.1 This is the Treasury Management Strategy Statement for the Police and Crime Commissioner (PCC) for Dorset.

1.2 The Police and Crime Commissioner PCC has adopted the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2017 Edition (the CIPFA Code) which requires the PCC to approve a Treasury Management Strategy before the start of each financial year.

1.3 In addition, this strategy also complies with elements of the Local Government Act 2003, the CIPFA Prudential Code, the Ministry of Housing, Communities and Local Government (MHCLG) MRP Guidance and MHCLG Investment Guidance.

1.4 This report fulfils the PCC's legal obligation under the Local Government Act 2003 to have regard to both the CIPFA Code and the MHCLG Guidance.

1.5 Treasury Management is the management of the PCC's cash flows, borrowing and investments, and the associated risks. The PCC funds are exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates as well as ensuring that revenue cash flow is adequately planned and funding is available to meet capital expenditure plans. The successful identification, monitoring and control of financial risk are therefore central to the PCC's prudent financial management.

1.6 In accordance with the MHCLG Guidance, the PCC will be asked to approve a revised Treasury Management Strategy Statement should the assumptions on which this report is based change significantly. Such circumstances would include, for example, a large unexpected change; in interest rates; in the PCC's capital programme, or in the level of its investment balances.

1.7 The Treasury Management Strategy supports the Medium Term Financial Plan and this document should be read in conjunction with the report on the Budget and Precept and Medium Term Financial Forecasts for 2020/21 to 2023/24.

1.8 This Strategy includes the Borrowing Strategy, the Investment Strategy and Prudential Indicators.

2.0 Treasury Management Strategy

2.1 On 31st March 2019 the PCC held £5.5m of treasury investments and £29m of debt.

2.2 This is set out in further detail in Appendix 1 Table 1. Forecast changes in these sums are shown in the balance sheet analysis in Appendix 1 Table 2.

2.3 The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. The PCC's current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing.

2.4 Over the forecast period CFR will decrease by the amounts reflecting the reduction in the PFI liabilities, and other capital financing charges (e.g. minimum revenue provision), and will increase by any new unfinanced capital expenditure.

2.5 CIPFA's Prudential Code for Capital Finance in Local Authorities recommends that total debt should be lower than the highest forecast CFR over the next three years. Appendix 1 Table 9 shows that the PCC expects to comply with this recommendation during 2020/21.

2.6 The economic background, credit outlook and interest rate forecasts, provided by Arlingclose, is shown at Appendix 4.

2.7 For the purpose of setting the budget, it has been assumed that new investments will be made at an average rate of 0.75%. For new borrowing the rate range is 1.3% to 2% depending on the term and source of the loan.

2.8 **Liability benchmark**: The liability benchmark is the minimum amount of debt that the PCC would hold if internal borrowing was used up to the maximum level possible (i.e. using all reserves and cashflow surpluses). The PCC's liability benchmark has been calculated and is shown at Appendix 1 Table 3. This assumes the same forecasts as Appendix 1 Table 2, but that cash and investment balances are kept to a minimum level of £1m at each year-end to maintain sufficient liquidity but minimise credit risk.

2.9 Following on from the medium-term forecasts in Appendix 1 Table 3, the long-term liability benchmark assumes capital expenditure funded by external and internal borrowing; and minimum revenue provision on new capital expenditure based on various years depending on the type of asset.

3.0 Borrowing Strategy

3.1 The PCC held £27.9m of PFI loans and £1.1m of other long term loans at the 31 March 2019.

3.2 **Objectives:** The chief objective when borrowing money is to strike an appropriately low risk balance between securing low interest costs and achieving certainty of those costs over the period for which funds are required. The flexibility to renegotiate loans should the PCC's long-term plans change is a secondary objective.

3.3 **Strategy:** Given the significant cuts in funding, the PCC borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. With short-term interest rates currently much lower than long-term rates, it is likely to be more cost effective in the short-term to either use internal resources, or to borrow short-term loans instead.

By doing so, the PCC is able to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk. The benefits of internal or short term borrowing will be monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing rates are forecast to rise modestly. Arlingclose will assist the PCC Treasurer with this 'cost of carry' and breakeven analysis. Its output may determine whether the PCC borrows additional sums at long-term fixed rates in 2020/21 with a view to keeping future interest costs low, even if this causes higher costs in the short-term.

The government increased PWLB rates by 1% in October 2019 making it now a relatively expensive option. The PCC will look to borrow any long-term loans from other sources including banks, pensions and local authorities, and will investigate the possibility of issuing bonds and similar instruments, in order to lower interest costs and reduce over-reliance on one source of funding in line with the CIPFA Code.

Alternatively, the PCC may arrange forward starting loans during 2020/21, where the interest rate is fixed in advance, but the cash is received in later years. This would enable certainty of cost to be achieved without suffering a cost of carry in the intervening period.

In addition, the PCC may borrow short-term loans to cover temporary cash flow shortages.

3.4 **Sources of borrowing:** The approved sources of long-term and short-term borrowing are:

- Public Works Loan Board (PWLB) and any successor body

- any institution approved for investments (see below)
- any other bank or building society authorised to operate in the UK
- any other UK public sector body
- UK public and private sector pension funds (except the Police Pension Funds)
- capital market bond investors
- UK Municipal Bonds Agency plc and other special purpose companies created to enable local authority bond issues

Other sources of debt finance: In addition, capital finance may be raised by the following methods that are not borrowing, but may be classed as other debt liabilities:

- leases
- hire purchase
- Private Finance Initiative
- sale and leaseback

3.5 **Municipal Bonds Agency:** UK Municipal Bonds Agency plc was established in 2014 by the Local Government Association as an alternative to the PWLB. It plans to issue bonds on the capital markets and lend the proceeds to local authorities. This will be a more complicated source of finance than the PWLB for two reasons: borrowing authorities will be required to provide bond investors with a guarantee to refund their investment in the event that the agency is unable to for any reason; and there will be a lead time of several months between committing to borrow and knowing the interest rate payable. Any decision to borrow from the Agency will therefore be the subject of a separate report to the PCC.

3.6 **Short-term and variable rate loans**: These loans leave the PCC exposed to the risk of short-term interest rate rises and are therefore subject to the interest rate exposure limits in the treasury management indicators below. Financial derivatives may be used to manage this interest rate risk.

3.7 **Debt rescheduling:** The PWLB allows authorities to repay loans before maturity and either pay a premium or receive a discount according to a set formula based on current interest rates. Other lenders may also be prepared to negotiate premature redemption terms. The PCC may take advantage of this and replace some loans with new loans, or repay loans without replacement, where this is expected to lead to an overall cost saving or a reduction in risk.

4.0 Investment Strategy

4.1 The PCC holds invested funds, representing income received in advance of expenditure plus balances and reserves held. In the first 6 months of 2019/20, the investment balance ranged between £0.1m and £32m. These levels may reduce in the forthcoming year.

4.2 **Objectives:** The CIPFA Code and the MHCLG Guidance requires the PCC 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 PCC'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. Where balances are expected to be invested for more than one year, the PCC will aim to achieve a total return that is equal or higher than the prevailing rate of inflation, in order to maintain the spending power of the sum invested.

4.3 **Negative interest rates:** If the UK enters into a recession in 2020/21, 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 investments 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.

4.4 **Strategy:** Given the increasing risk and very low returns from short-term unsecured bank investments, the PCC aims to diversify into more secure and where possible higher yielding asset classes during 2020/21.

4.5 **Business Model:** Under the IFRS 9 Financial Instruments standard, the accounting for certain investments depends on the PCC's approach to managing them. The PCC aims is to achieve value from internally managed treasury investments by a business model of collecting the contractual cash flows and therefore, where other criteria are also met, such investments will continue to be accounted for at amortised cost.

4.6 **Approved counterparties:** The PCC may invest its surplus funds with certain counterparty types subject to the cash limits (per counterparty) and time limits. The PCC will only invest with those counterparties recommended by Arlingclose. The PCC recognises that during a year cashflow can be in excess of £20m for a significant period following the receipt of the pensions grant in July. Taking this period into account, Appendix 1 Table 4 shows each counterparty type and corresponding limits.

4.7 **Credit rating:** Investment limits are set by reference to the lowest published long-term credit rating from a selection of external rating agencies. Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used. However, investment decisions are never made solely based on credit ratings, and all other relevant factors including external advice will be taken into account.

4.8 **Banks unsecured:** Accounts, deposits, certificates of deposit and senior unsecured bonds with banks and building societies, other than multilateral development banks. These investments are subject to the risk of credit loss via a bail-in should the regulator determine that the bank is failing or likely to fail (see below for arrangements relating to operational bank accounts).

4.9 **Banks secured:** Covered bonds, reverse repurchase agreements and other collateralised arrangements with banks and building societies. These investments are secured on the bank's assets, which limits the potential losses in the unlikely event of insolvency, and means that they are exempt from bail-in. Where there is no investment specific credit rating, but the collateral upon which the investment is secured has a credit rating, the higher of the collateral credit rating and the counterparty credit rating will be used to determine cash and time limits. The combined secured and unsecured investments in any one bank will not exceed the cash limit for secured investments.

4.10 **Government:** Loans, bonds and bills issued or guaranteed by national governments, regional and local authorities and multilateral development banks. These investments are not subject to bail-in, and there is generally a lower risk of insolvency, although they are not zero risk. Investments with the UK Central Government may be made in unlimited amounts for up to 50 years.

4.11 **Corporates:** Loans, bonds and commercial paper issued by companies other than banks and registered providers. These investments are not subject to bail-in, but are exposed to the risk of the company going insolvent. Loans to unrated companies will only be made as part of a diversified pool in order to spread the risk widely and only following an external credit assessment.

4.12 **Registered providers:** Loans and bonds issued by, guaranteed by or secured on the assets of registered providers of social housing and registered social landlords, formerly known as housing associations. These bodies are tightly regulated by the Regulator of Social Housing (in England), the Scottish Housing Regulator, the Welsh Government and the Department of Communities (in Northern Ireland). As providers of public services, they retain the likelihood of receiving government support if needed.

4.13 **Pooled funds:** Shares or units in diversified investment vehicles consisting of any of the above investment types, plus equity shares and property. These funds have the advantage of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a fee. Short-term Money Market Funds that offer same-day liquidity and very low or no volatility will be used as an alternative to instant access bank accounts, while pooled funds whose value changes with market prices and/or have a notice period will be used for longer investment periods.

Bond, equity and property funds offer enhanced returns over the longer term, but are more volatile in the short term. These allow the PCC to diversify into asset classes other than cash without the need to own and manage the underlying investments. As these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the PCC's investment objectives will be monitored regularly. Any such investment would require the explicit approval of the PCC.

4.14 **Operational bank accounts:** The PCC's operational bank account is held with NatWest. The PCC may incur operational exposures, for example though current accounts, collection accounts and merchant acquiring services, to any UK bank with credit ratings no lower than BBB- and with assets greater than £25 billion. These are not classed as investments, but are still subject to the risk of a bank bail-in, and balances will therefore be kept below £1.25m per bank. The Bank of England has stated that in the event of failure, banks with assets greater than £25 billion are more likely to be bailed-in than made insolvent, increasing the chance of the PCC maintaining operational continuity.

4.15 **Risk assessment and credit ratings**: Credit ratings are obtained and monitored by the PCC's treasury advisers, who will notify changes in ratings as they occur. Where an entity has its credit rating downgraded so that it fails to meet the approved investment criteria then:

- no new investments will be made,
- any existing investments that can be recalled or sold at no cost will be, and
- full consideration will be given to the recall or sale of all other existing investments with the affected counterparty.

Where a credit rating agency announces that a credit rating is on review for possible downgrade (also known as "rating watch negative" or "credit watch negative") so that it may fall below the approved rating criteria, then only investments that can be withdrawn on the next working day will be made with that organisation until the outcome of the review is announced. This policy will not apply to negative outlooks, which indicate a long-term direction of travel rather than an imminent change of rating.

4.16 **Other information on the security of investments**: The PCC understands that credit ratings are good, but not perfect, predictors of investment default. Full regard will therefore be given to other available information on the credit quality of the organisations in which it invests, including credit default swap prices, financial statements, information on potential government support and reports in the quality financial press and analysis and advice from the PCC's treasury management adviser. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may otherwise meet the credit rating criteria.

When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008 and 2011, this is not generally reflected in credit ratings, but can be seen in other market measures. In these circumstances, the PCC will restrict its investments to those organisations of higher credit quality and reduce the maximum duration of its investments to maintain the required level of security. The extent of these restrictions will be in line with prevailing financial market conditions. If these restrictions mean that insufficient commercial organisations of high credit quality are available to invest the PCC's cash balances, then the surplus will be deposited with the UK Government, via the Debt Management Office or invested in government treasury bills for example, or with other local authorities. This will cause a reduction in the level of investment income earned, but will protect the principal sum invested.

4.17 **Specified investments**: The MHCLG Guidance defines specified investments as those:

- denominated in pound sterling,
- due to be repaid within 12 months of arrangement,
- not defined as capital expenditure by legislation, and
- invested with one of:
  - the UK Government,
  - a UK local authority, parish council or community council, or
  - a body or investment scheme of "high credit quality".

The PCC defines "high credit quality" organisations and securities as those having a credit rating of [A-] or higher that are domiciled in the UK or a foreign country with a sovereign rating of [AA+] or higher. For money market funds and other pooled funds "high credit quality" is defined as those having a credit rating of [A-] or higher.

4.18 **Non-specified investments**: Any investment not meeting the definition of a specified investment is classed as non-specified. The PCC does not intend to make any investments denominated in foreign currencies, nor any that are defined as capital expenditure by legislation, such as company shares. Non-specified investments will therefore be limited to long-term investments, i.e. those that are due to mature 12 months or longer from the date of arrangement, and investments with bodies and schemes not meeting the definition on high credit quality. Limits on non-specified investments are shown in Appendix 1 Table 5.

4.19 **Investment limits**: The PCC's revenue reserves available to cover investment losses are forecast to be £5m on 31st March 2021. In the case of a single default, the maximum that will be lent to any one organisation (other than the UK Government) will be £3m for unsecured funds. This is a revision to the strategy that was approved in February 2020 which stated a maximum of £1m. Given the market conditions that have arisen during the year, this maximum has been reviewed and a recommendation put forward to increase it to £3m. This recommendation was approved by the Police and Crime Commissioner for Dorset in September 2020. A group of banks under the same ownership will be treated as a single organisation for limit purposes. Limits will also be placed on fund managers, investments in brokers' nominee accounts, foreign countries and industry sectors as below. Investments in pooled funds and multilateral development banks do not count against the limit for any single foreign country, since the risk is diversified over many countries. Investment limits are shown in Appendix 1 Table 6.

4.20 **Liquidity management**: The PCC uses purpose-built cash flow forecasting spreadsheet to determine the maximum period for which funds may prudently be committed. The forecast is compiled on a prudent basis to minimise the risk of the PCC being forced to borrow on unfavourable terms to meet its financial commitments. Limits on long-term investments are set by reference to the PCC's medium term financial plan and cash flow forecast.

4.21 Heritable Bank: In 2008, Dorset Police Authority made three temporary investments to two Icelandic banks, Landsbanki and Heritable. The investments met the criteria set out in the 2008/09 Treasury Management Strategy. A balance of c.£40k remains outstanding from an original investment with Heritable Bank of £2.035m. Legal proceedings are on-going.

5.0 <u>2018 MHCLG Investment Guidance</u>

5.1 The contribution that Treasury Management Investments make to the objectives of the PCC group is to support effective treasury management activities.

5.2 The statutory guidance issued by MHCLG in January 2018 requires authorities to report also on their investment strategy with regard to the following purposes:

- To support local public services by lending to or buying shares in other organisations (service investments), and

- To earn investment income (known as commercial investments where this is the main purpose)

5.3 The PCC does not have any current plans for such investments. Should these plans change in the future a full assessment will be made and an appropriate Investment Strategy Report will be prepared.

5.4 Financial guarantees are not strictly counted as investments, since no money has exchanged hands yet, but they do carry risks. The PCC, along with all other PCCs, provided a financial guarantee for the Police ICT Company amounting to c. £53k for Dorset. This would be covered within the General Fund Balance reserve.

6.0 Prudential Indicators

6.1 The Local Government Act 2003 requires the PCC to have regard to the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code) when determining how much money it can afford to borrow. The objectives of the Prudential Code are to ensure, within a clear framework, that the capital investment plans of the PCC are affordable, prudent and sustainable, and that treasury management decisions are taken in accordance with good professional practice. To demonstrate that the PCC has fulfilled these objectives, the Prudential Code sets out the following indicators that must be set and monitored each year:

i) Estimates of Capital Expenditure: The PCC's planned capital expenditure and financing is shown in Table 7 in Appendix 2 as well as the **estimates of Capital Financing Requirement:** The Capital Financing Requirement (CFR) (Table 8 in Appendix 2) measures the PCC's underlying need to borrow for a capital purpose.

ii) Gross Debt and the Capital Financing Requirement: In order to ensure that over the medium term debt will only be for a capital purpose, the PCC should ensure that debt does not, except in the short term, exceed the total of capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years. This is a key indicator of prudence which is shown in Appendix 2 Table 9.

iii) Operational Boundary for External Debt: The operational boundary shown in Appendix 2 Table 10 is based on the PCC's estimate of most likely (i.e. prudent but not worst case) scenario for external debt. It links directly to the PCC's estimates of capital expenditure, the capital financing requirement and cash flow requirements, and is a key management tool for in-year monitoring. Other long-term liabilities comprise finance lease, Private Finance Initiative and other liabilities.

iv) Authorised Limit for External Debt: The authorised limit shown in Appendix 2 Table 11 is the affordable borrowing limit determined in compliance with the Local Government Act 2003. It is the maximum amount of debt that the PCC can legally owe. The authorised limit provides headroom over and above the operational boundary for unusual cash movements.

v) Ratio of Financing Costs to Net Revenue Stream: This is an indicator of affordability and highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet financing costs. This is shown in Appendix 2 Table 12.

7.0 Treasury Management Indicators

7.1 The PCC measures and manages its exposures to treasury management risks using the following indicators.

i) Security: The PCC has adopted a voluntary measure of its exposure to credit risk by monitoring the weighted average credit rating of its investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment. Unrated investments are assigned a score based on their perceived risk.

	Target
Portfolio average credit rating	A+

ii) Liquidity: Minimum limits are set for short term cash in order that sufficient liquidity is available to meet unexpected variation in the cash flow:

	Target
Minimum limit at less than 90 days duration	£5m

iii) Interest rate exposures: This indicator is set to control the PCC's exposure to interest rate risk. The upper limits on fixed and variable rate interest rate exposures, expressed as the amount of net interest payable will be:

	2020/21
	Limit
Upper limit on 1 year revenue impact of a 1% rise in interest rates	£75k
Upper limit on 1 year revenue impact of a 1% fall in interest rates	£110k

The impact of a change in interest rates is calculated on the assumption that maturing loans and investments will be replaced at current rates.

iv) Maturity structure of borrowing: This indicator is set to control the PCC's exposure to refinancing risk. The upper and lower limits on the maturity structure of fixed rate borrowing will be:

	Upper	Lower
Under 12 months	100%	0%
12 months and within 24 months	100%	0%
24 months and within 5 years	100%	0%
5 years and within 10 years	100%	0%
10 years and above	100%	0%

Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment.

v) Principal sums invested for periods longer than a year: The purpose of this indicator is to control the PCC's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the long-term principal sum invested to final maturities beyond the period end will be:

PCC	2020/21	2021/22	2022/23	2023/24
Limit on principal invested beyond year end	£4m	£4m	£4m	£4m

8.0 <u>Other Items</u>

8.1 The CIPFA Code requires the PCC to also include the items below in its Treasury Management Strategy.

8.2 **Financial derivatives:** In the absence of any explicit legal power to do so, the PCC will not use standalone financial derivatives (such as swaps, forwards, futures and options). Derivatives embedded into loans and investments, including pooled funds and forward starting transactions, may be used, and the risks that they present will be managed in line with the overall treasury risk management strategy.

In line with the CIPFA Code, the PCC will seek external advice and will consider that advice before entering into financial derivatives to ensure that it fully understands the implications.

8.3 **Investment training:** The needs of the PCC's treasury management staff for training in investment management are assessed on an ongoing basis and as part of the staff appraisal process, and additionally when the responsibilities of individual members of staff change.

Staff attend internal training courses and/or training courses, seminars and conferences provided by Arlingclose and CIPFA.

8.4 **Investment advisers:** The PCC has appointed Arlingclose Limited as treasury management advisers and receives specific advice on investment, debt and capital finance issues.

8.5 **Investment of money borrowed in advance of need**: The PCC may, from time to time, borrow in advance of need, where this is expected to provide the best long-term value for money. Since amounts borrowed will be invested until spent, the PCC is aware that it will be exposed to the risk of loss of the borrowed sums, and the risk that investment and borrowing interest rates may change in the intervening period. These risks will be managed as part of the PCC's overall management of its treasury risks.

The total amount borrowed will not exceed the authorised borrowing limit. The maximum period between borrowing and expenditure is expected to be two years, although the PCC is not required to link particular loans with particular items of expenditure.

8.6 The Minimum Revenue Provision (MRP) Policy Statement is shown in Appendix 3. MRP is an amount charged to the revenue budget for the repayment of debt. The Local Government Act 2003 requires the PCC to have regard to the MHCLG Guidance on Minimum Revenue Provision, most recently issued in 2020.

9.0 Financial Implications

9.1 The budget for investment income in 2020/21 is £80k, based on an average investment portfolio of £10.6m at an average interest rate of 0.75%. If actual levels of investments and borrowing, and actual interest rates differ from those forecast, performance against budget will be correspondingly different.

10.0 Other Options Considered

10.1 The MHCLG Guidance and the CIPFA Code do not prescribe any particular treasury management strategy for local authorities to adopt. The Treasurer, having consulted the PCC believes that the above strategy represents an appropriate balance between risk management and cost effectiveness. Some alternative strategies, with their financial and risk management implications, are considered below.

Alternative	Impact on income and expenditure	Impact on risk management
Invest in a narrower range of counterparties and/or for shorter times	Interest income will be lower	Lower chance of losses from credit related defaults, but any such losses may be greater
Invest in a wider range of counterparties and/or for longer times	Interest income will be higher	Increased risk of losses from credit related defaults, but any such losses may be smaller
Borrow additional sums at long-term fixed interest rates	Debt interest costs will rise; this is unlikely to be offset by higher investment income	Higher investment balance leading to a higher impact in the event of a default; however long-term interest costs may be more certain
Borrow short-term or variable loans instead of long-term fixed rates	Debt interest costs will initially be lower	Increases in debt interest costs will be broadly offset by rising investment income in the medium term, but long-term costs may be less certain
Reduce level of borrowing	Saving on debt interest is likely to exceed lost investment income	Reduced investment balance leading to a lower impact in the event of a default; however long-term interest costs may be less certain

11.0 Governance Arrangements

11.1 The Treasury Management governance arrangements are set out in Appendix 5.

Appendices

Appendix 1: Investment Strategy
Appendix 2: Prudential Indicators
Appendix 3: Minimum Revenue Provision Statement
Appendix 4: Economic context
Appendix 5: Treasury Management Governance Arrangements

INVESTMENT STRATEGY **Appendix 1**

Table 1
Existing Investment & Debt Portfolio Position

	31st March 2019 Actual Portfolio £'000
External Borrowing:	
Total External Borrowing	**0**
Other Long-Term Liabilities: Private Finance Initiative Other long term liabilities	 (27,978) (1,086)
Total Other Long-Term Liabilities	**(29,064)**
Total Gross External Debt	**(29,064)**
Treasury Investments: Short-term investments Cash and cash equivalents	 3,469 2,052
Total Treasury Investments	**5,521**
Net Debt	**(23,543)**

INVESTMENT STRATEGY **Appendix 1**

Table 2

Balance Sheet Summary and Forecast

	31.3.20 Forecast £'000	31.3.21 Estimate £'000	31.3.22 Estimate £'000	31.3.23 Estimate £'000	31.3.24 Estimate £'000
Total Capital Financing Requirement	**32,812**	**41,285**	**49,421**	**57,923**	**58,069**
Less: PFI Liabilities	(25,975)	(24,802)	(24,563)	(22,508)	(20,453)
Less: Other Long Term Liabilities	(966)	(846)	(727)	(607)	(489)
Less: External Borrowing	(5,241)	(15,129)	(24,131)	(34,809)	(37,128)
Internal Borrowing	**630**	**508**	**0**	**0**	**0**
Usable Reserves	(6,841)	(5,253)	(5,353)	(5,453)	(5,453)
Working Capital	(1,600)	(1,600)	(1,600)	(1,600)	(1,600)
Total Funds	**(8,441)**	**(6,853)**	**(6,953)**	**(7,053)**	**(7,053)**
New borrowing or (Treasury investments)	**(7,811)**	**(6,345)**	**(6,953)**	**(7,053)**	**(7,053)**

Table 3

Liability Benchmark

	31.3.20 Forecast £'000	31.3.21 Estimate £'000	31.3.22 Estimate £'000	31.3.23 Estimate £'000	31.3.24 Estimate £'000
Total Capital Financing Requirement	**32,812**	**41,285**	**49,421**	**57,923**	**58,069**
Less: PFI	(26,942)	(25,649)	(25,290)	(23,115)	(20,942)
Less: Usable Reserves	(6,841)	(5,253)	(5,353)	(5,453)	(5,453)
Less: Working Capital	(1,600)	(1,600)	(1,600)	(1,600)	(1,600)
Plus: Minimum Investments	1,000	1,000	1,000	1,000	1,000
Liability Benchmark	**(1,571)**	**9,783**	**18,178**	**28,755**	**31,074**

Table 4

Counterparty Types (Applied from 1st October 2020)

Credit Rating	Banks Unsecured	Banks Secured	Government	Corporates	Registered Providers
UK Govt	n/a	n/a	£ Unlimited 50 years	n/a	n/a
AAA	£3m 5 years	£3m 20 years	£1m 50 years	£0.35m 20 years	£0.5m 20 years
AA+	£3m 5 years	£3m 10 years	£1m 25 years	£0.35m 10 years	£0.5m 10 years
AA	£3m 4 years	£3m 5 years	£1m 15 years	£1m 5 years	£0.5m 10 years
AA-	£3m 3 years	£3m 4 years	£1m 10 years	£1m 3 years	£0.5m 10 years
A+	£3m 2 years	£3m 3 years	£0.5m 5 years	£1m 3 years	£0.5m 5 years
A	£3m 13 months	£3m 2 years	£0.5m 5 years	£1m 2 years	£0.5m 5 years
A-	£3m 6 months	£3m 13 months	£0.5m 5 years	£1m 13 months	£0.5m 5 years
None	£0.15m 6 months	n/a	£0.5m 25 years	£1m 5 years	£0.5m 5 years
Pooled funds	£3m per fund				

Counterparty Types (Applied between 1st April 2020 to 30th September 2020)

Credit Rating	Banks Unsecured	Banks Secured	Government	Corporates	Registered Providers
UK Govt	n/a	n/a	£ Unlimited 50 years	n/a	n/a
AAA	£1m 5 years	£2m 20 years	£1m 50 years	£0.35m 20 years	£0.5m 20 years
AA+	£1m 5 years	£2m 10 years	£1m 25 years	£0.35m 10 years	£0.5m 10 years

INVESTMENT STRATEGY **Appendix 1**

AA	£1m 4 years	£2m 5 years	£1m 15 years	£1m 5 years	£0.5m 10 years
AA-	£1m 3 years	£2m 4 years	£1m 10 years	£1m 3 years	£0.5m 10 years
A+	£1m 2 years	£2m 3 years	£0.5m 5 years	£1m 3 years	£0.5m 5 years
A	£1m 13 months	£2m 2 years	£0.5m 5 years	£1m 2 years	£0.5m 5 years
A-	£1m 6 months	£2m 13 months	£0.5m 5 years	£1m 13 months	£0.5m 5 years
None	£0.15m 6 months	n/a	£0.5m 25 years	£1m 5 years	£0.5m 5 years
Pooled funds	£1m per fund				

INVESTMENT STRATEGY **Appendix 1**

Table 5

Non-Specified Investment Limits

	Cash limit
Total long-term investments	£3m
Total investments without credit ratings or rated below [A-] (except UK Government and local authorities)	£2m
Total investments (except pooled funds) with institutions domiciled in foreign countries rated below [AA+]	£2m
Total non-specified investments	£15m

Table 6

Investment Limits

	Cash Limit
Any single organisation, except the UK Government and Local Authority	£3m each
Any Local Authority	£5m each
Any group of organisations under the same ownership	£2m per Group
Any group of pooled funds under the same management	£3m per manager
Negotiable instruments held in a broker's nominee account	£12m per Broker
Limit per non-UK country	£1m per country
Registered providers	£3m in Total
Unsecured investments with building societies	£3m in Total
Money Market Funds	£15m in Total
Bank Account	£1.25m

PRUDENTIAL INDICATORS **Appendix 2**

Table 7

Estimates of Capital Expenditure

	2019/20	2020/21	2021/22	2022/23	2023/24
	Forecast	Estimate	Estimate	Estimate	Estimate
	£'000	£'000	£'000	£'000	£'000
Total Expenditure	**9,258**	**12,109**	**12,056**	**15,756**	**8,053**
Capital Receipts	1,631	0	0	0	0
Government Grants	421	110	110	110	110
Reserves	665	0	0	0	0
Revenue	1,300	2,111	2,611	3,111	3,611
Borrowing	5,241	9,888	9,335	12,535	4,332
Total Financing	**9,258**	**12,109**	**12,056**	**15,756**	**8,053**

Table 8

Capital Financing Requirement

	2019/20	2020/21	2021/22	2022/23	2023/24
	Forecast	Estimate	Estimate	Estimate	Estimate
	£'000	£'000	£'000	£'000	£'000
Opening CFR	**30,225**	**32,812**	**41,285**	**49,421**	**57,923**
Capital expenditure to be funded by borrowing	5,241	9,888	9,335	12,535	4,332
Less: Repayment of PFI	(2,004)	(1,173)	(238)	(2,056)	(2,055)
Less: Repayment of Other Long Term Liabilities	(120)	(120)	(120)	(119)	(118)
Less: Minimum Revenue Provision	(530)	(122)	(841)	(1,858)	(2,013)
Closing CFR	**32,812**	**41,285**	**49,421**	**57,923**	**58,069**

PRUDENTIAL INDICATORS **Appendix 2**

Table 9

Total Debt

Debt	2019/20 Forecast £'000	2020/21 Estimate £'000	2021/22 Estimate £'000	2022/23 Estimate £'000	2023/24 Estimate £'000
PFI liabilities	25,975	24,802	24,563	22,508	20,453
Other Long Term Liabilities	966	846	727	607	489
Internal Borrowing	631	507	0	0	0
External Borrowing	5,240	15,129	24,131	34,808	37,127
Total Debt	**32,812**	**41,285**	**49,421**	**57,923**	**58,069**

Table 10

Operational Boundary for External Debt

Operational Boundary	2019/20 Forecast £'000	2020/21 Estimate £'000	2021/22 Estimate £'000	2022/23 Estimate £'000	2023/24 Estimate £'000
PFI and Other long-term liabilities	26,941	25,648	25,290	23,115	20,942
External Borrowing	5,240	15,129	24,131	34,808	37,127
Maximum forecast cashflow deficit arising from revenue budget operations	10,000	10,000	10,000	10,000	10,000
Total Operational Boundary	**42,180**	**50,777**	**59,421**	**67,923**	**68,069**

Table 11

Authorised Limit for External Debt

Authorised Limit	2019/20 Forecast £'000	2020/21 Estimate £'000	2021/22 Estimate £'000	2022/23 Estimate £'000	2023/24 Estimate £'000
Total Operational Boundary Debt	**42,180**	**50,777**	**59,421**	**67,923**	**68,069**
Additional margin for unforeseen circumstances	5,000	5,000	5,000	5,000	5,000
Total Authorised Limit	**47,180**	**55,777**	**64,421**	**72,923**	**73,069**

MINIMUM REVENUE PROVISION **Appendix 3**

Annual Minimum Revenue Provision Statement 2020/21

Where the PCC finances capital expenditure by debt, it must put aside resources to repay that debt in later years. The amount charged to the revenue budget for the repayment of debt is known as Minimum Revenue Provision (MRP), although there has been no statutory minimum since 2008. The Local Government Act 2003 requires the PCC to have regard to the Ministry of Housing, Communities and Local Government's (MHCLG) Guidance on Minimum Revenue Provision. The broad aim of the MHCLG Guidance is to ensure that debt is repaid over a period that is either reasonably commensurate with that over which the capital expenditure provides benefits.

The MHCLG Guidance requires the PCC to approve an Annual MRP Statement each year, and provides four options for calculating an amount to put aside to revenue over time to cover the CFR i.e. the MRP. The PCC has opted for option 3; the Asset Life Method. The Asset Life Method determines that MRP is calculated on the basis of charging the unfinanced capital expenditure over the expected useful life of the relevant assets based on either an equal instalment method or an annuity method. The PCC has opted for the equal instalment method. This is applied from the year after the asset becomes operational. For assets acquired by finance leases or the Private Finance Initiative, MRP will be determined as being equal to the element of the rent or charge that goes to write down the balance sheet liability.

The PCC can choose to make more MRP than considered the prudent minimum.

The maximum asset life used in MRP calculations is 50 years, unless a longer life is certified by an appropriately qualified professional adviser, or the asset has been acquired on a lease of longer than 50 years. For those assets purchased before 1st April 2020 that have an asset life of more than 50 years, the Code does not require a retrospective adjustment.

Based on the PCC's latest estimate of its Capital Financing Requirement on 31st March 2020, the budget for MRP has been set as follows:

	2020/21 Estimated CFR £'000	2020/21 Estimated MRP £'000
Unsupported capital expenditure after 31.03.2008	32,812	530

ECONOMIC CONTEXT **Appendix 4**

Arlingclose Economic and Interest Rate Forecast November 2019

Economic background: The UK's progress negotiating its exit from the European Union, together with its future trading arrangements, will continue to be a major influence on the Authority's treasury management strategy for 2020/21.

UK Consumer Price Inflation (CPI) for September registered 1.7% year on year, unchanged from the previous month. Core inflation, which excludes the more volatile components, rose to 1.7% from 1.5% in August. The most recent labour market data for the three months to August 2019 showed the unemployment rate ticked back up to 3.9% while the employment rate was 75.9%, just below recent record-breaking highs. The headline 3-month average annual growth rate for pay was 3.8% in August as wages continue to rise steadily. In real terms, after adjusting for inflation, pay growth increased 1.9%.

GDP growth rose by 0.3% in the third quarter of 2019 from -0.2% in the previous three months with the annual rate falling further below its trend rate to 1.0% from 1.2%. Services and construction added positively to growth, by 0.6% and 0.4% respectively, while production was flat and agriculture recorded a fall of 0.2%. Looking ahead, the Bank of England's Monetary Policy Report (formerly the Quarterly Inflation Report) forecasts economic growth to pick up during 2020 as Brexit-related uncertainties dissipate and provide a boost to business investment helping GDP reach 1.6% in Q4 2020, 1.8% in Q4 2021 and 2.1% in Q4 2022.

The Bank of England maintained Bank Rate to 0.75% in November following a 7-2 vote by the Monetary Policy Committee. Despite keeping rates on hold, MPC members did confirm that if Brexit uncertainty drags on or global growth fails to recover, they are prepared to cut interest rates as required. Moreover, the downward revisions to some of the growth projections in the Monetary Policy Report suggest the Committee may now be less convinced of the need to increase rates even if there is a Brexit deal.

Growth in Europe remains soft, driven by a weakening German economy which saw GDP fall -0.1% in Q2 and is expected to slip into a technical recession in Q3. Euro zone inflation was 0.8% year on year in September, well below the European Central Bank's target of 'below, but close to 2%' and leading to the central bank holding its main interest rate at 0% while cutting the deposit facility rate to -0.5%. In addition to maintaining interest rates at ultra-low levels, the ECB announced it would recommence its quantitative easing programme from November.

In the US, the Federal Reserve began easing monetary policy again in 2019 as a pre-emptive strike against slowing global and US economic growth on the back on of the ongoing trade war with China. At its last meeting the Fed cut rates to the range of 1.50-

1.75% and financial markets expect further loosening of monetary policy in 2020. US GDP growth slowed to 1.9% annualised in Q3 from 2.0% in Q2.

Credit outlook: Credit conditions for larger UK banks have remained relatively benign over the past year. The UK's departure from the European Union was delayed three times in 2019 and while there remains some concern over a global economic slowdown, this has yet to manifest in any credit issues for banks. Meanwhile, the post financial crisis banking reform is now largely complete, with the new ringfenced banks embedded in the market.

Challenger banks hit the news headlines in 2019 with Metro Bank and TSB Bank both suffering adverse publicity and falling customer numbers.

Looking forward, the potential for a "no-deal" Brexit and/or a global recession remain the major risks facing banks and building societies in 2020/21 and a cautious approach to bank deposits remains advisable.

Interest rate forecast: The Authority's treasury management adviser Arlingclose is forecasting that Bank Rate will remain at 0.75% until the end of 2022. The risks to this forecast are deemed to be significantly weighted to the downside, particularly given the upcoming general election, the need for greater clarity on Brexit and the continuing global economic slowdown. The Bank of England, having previously indicated interest rates may need to rise if a Brexit agreement was reached, stated in its November Monetary Policy Report and its Bank Rate decision (7-2 vote to hold rates) that the MPC now believe this is less likely even in the event of a deal.

Gilt yields have risen but remain at low levels and only some very modest upward movement from current levels are expected based on Arlingclose's interest rate projections. The central case is for 10-year and 20-year gilt yields to rise to around 1.00% and 1.40% respectively over the time horizon, with broadly balanced risks to both the upside and downside. However, short-term volatility arising from both economic and political events over the period is a near certainty.

Underlying assumptions:

- The global economy is entering a period of slower growth in response to political issues, primarily the trade policy stance of the US. The UK economy has displayed a marked slowdown in growth due to both Brexit uncertainty and the downturn in global activity. In response, global and UK interest rate expectations have eased.

- Some positivity on the trade negotiations between China and the US has prompted worst case economic scenarios to be pared back. However, information is limited, and upbeat expectations have been wrong before.

ECONOMIC CONTEXT **Appendix 4**

- Brexit has been delayed until 31 January 2020. While the General Election has maintained economic and political uncertainty, the opinion polls suggest the Conservative position in parliament may be strengthened, which reduces the chance of Brexit being further frustrated. A key concern is the limited transitionary period following a January 2020 exit date, which will maintain and create additional uncertainty over the next few years.

- UK economic growth has stalled despite Q3 2019 GDP of 0.3%. Monthly figures indicate growth waned as the quarter progressed and survey data suggest falling household and business confidence. Both main political parties have promised substantial fiscal easing, which should help support growth.

- While the potential for divergent paths for UK monetary policy remain in the event of the General Election result, the weaker external environment severely limits potential upside movement in Bank Rate, while the slowing UK economy will place pressure on the MPC to loosen monetary policy. Indeed, two MPC members voted for an immediate cut in November 2019.

- Inflation is running below target at 1.7%. While the tight labour market risks medium-term domestically-driven inflationary pressure, slower global growth should reduce the prospect of externally driven pressure, although political turmoil could push up oil prices.

- Central bank actions and geopolitical risks will continue to produce significant volatility in financial markets, including bond markets.

Forecast:

- Although we have maintained our Bank Rate forecast at 0.75% for the foreseeable future, there are substantial risks to this forecast, dependant on General Election outcomes and the evolution of the global economy.

- Arlingclose judges that the risks are weighted to the downside.

- Gilt yields have risen but remain low due to the soft UK and global economic outlooks. US monetary policy and UK government spending will be key influences alongside UK monetary policy.

- We expect gilt yields to remain at relatively low levels for the foreseeable future and judge the risks to be broadly balanced.

POLICE AND CRIME COMMISSIONER FOR DORSET
2020/21 TREASURY MANAGEMENT AND INVESTMENT STRATEGY

ECONOMIC CONTEXT **Appendix 4**

	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Average
Official Bank Rate														
Upside risk	0.00	0.00	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.21
Arlingclose Central Case	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75
Downside risk	-0.50	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.73
3-month money market rate														
Upside risk	0.10	0.10	0.25	0.25	0.25	0.25	0.25	0.25	0.30	0.30	0.30	0.30	0.30	0.25
Arlingclose Central Case	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75
Downside risk	-0.50	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.73
1yr money market rate														
Upside risk	0.10	0.20	0.20	0.20	0.20	0.20	0.20	0.25	0.30	0.30	0.30	0.30	0.30	0.23
Arlingclose Central Case	0.85	0.85	0.85	0.85	0.85	0.85	0.85	0.85	0.85	0.85	0.85	0.85	0.85	0.85
Downside risk	-0.30	-0.50	-0.55	-0.65	-0.65	-0.65	-0.65	-0.65	-0.65	-0.65	-0.65	-0.65	-0.65	-0.60
5yr gilt yield														
Upside risk	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	0.45	0.45	0.45	0.37
Arlingclose Central Case	0.50	0.50	0.50	0.55	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.57
Downside risk	-0.35	-0.50	-0.50	-0.55	-0.60	-0.60	-0.60	-0.60	-0.60	-0.60	-0.60	-0.60	-0.60	-0.56
10yr gilt yield														
Upside risk	0.30	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	0.40	0.45	0.45	0.37
Arlingclose Central Case	0.75	0.75	0.80	0.80	0.85	0.85	0.90	0.90	0.95	0.95	1.00	1.00	1.00	0.88
Downside risk	-0.40	-0.40	-0.40	-0.40	-0.45	-0.45	-0.45	-0.45	-0.50	-0.50	-0.50	-0.50	-0.50	-0.45
20yr gilt yield														
Upside risk	0.30	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	0.40	0.45	0.45	0.37
Arlingclose Central Case	1.20	1.20	1.25	1.25	1.25	1.30	1.30	1.30	1.35	1.35	1.35	1.40	1.40	1.30
Downside risk	-0.40	-0.40	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.50	-0.50	-0.45
50yr gilt yield														
Upside risk	0.30	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	0.40	0.45	0.45	0.37
Arlingclose Central Case	1.20	1.20	1.25	1.25	1.25	1.30	1.30	1.30	1.35	1.35	1.35	1.40	1.40	1.30
Downside risk	-0.40	-0.40	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.50	-0.50	-0.45

PWLB Certainty Rate (Maturity Loans) = Gilt yield + 1.80%
PWLB Local Infrastructure Rate (Maturity Loans) = Gilt yield + 0.60%

GOVERNANCE ARRANGEMENTS **Appendix 5**

Treasury Management Governance Arrangements

The PCC is responsible for:

- receiving and reviewing reports on treasury management policies, practices and activities;
- approval of annual strategy.
- approval of/amendments to the treasury management policy statement and treasury management practices;
- budget consideration and approval;
- approval of the division of responsibilities;
- receiving and reviewing regular monitoring reports and acting on recommendations;
- approving the selection of external service providers and agreeing terms of appointment.

The Independent Audit Committee is responsible for:

- scrutinising the treasury management policy and procedures and making recommendations to the PCC.

The Treasurer is responsible for:

- recommending clauses, treasury management policy/practices for approval, reviewing the same regularly, and monitoring compliance;
- submitting regular treasury management policy reports;
- submitting budgets and budget variations;
- receiving and reviewing management information reports;
- reviewing the performance of the treasury management function;
- ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function;
- ensuring the adequacy of internal audit, and liaising with external audit;
- recommending the appointment of external service providers.