DORSET
POLICE & CRIME COMMISSIONER
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TREASURY MANAGEMENT STRATEGY 2023/24 to 2026/27

POLICE AND CRIME COMMISSIONER FOR DORSET
2023/24 to 2026/27 TREASURY MANAGEMENT STRATEGY STATEMENT

1.0 Introduction

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

1.2 The PCC has adopted the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2021 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 is integral to the Medium Term Financial Plan (MTFP) and this document should be read in conjunction with the report on the MTFP for 2023/24 to 2026/27.

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

2.0 Treasury Management Strategy

2.1 On 31 March 2022 the PCC held treasury investments totalling £12.481mn and £36.183mn external 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 existing liabilities (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 the total debt should be lower than its highest forecast CFR over the next three years. Appendix 2 Table 9 shows that the PCC expects to comply with this recommendation during 2023/24.

2.6 The economic background, credit outlook and interest rate forecasts, provided by Arlingclose, is shown at Appendix 5.

2.7 Investment interest rates have been very volatile in 2022/23. Arlingclose Limited forecast the bank rate to reach 4.25% by March 2024. Taking into account this forecast and the time lag between bank base rate and money market rates, an interest income budget of £160k has been set for 2023/24. For new borrowing the rate range (November 2022) is 2.85% to 4.73% depending on the term and source of the loan.

2.8 **Liability benchmark**: To compare the PCC's actual borrowing against an alternative strategy, a liability benchmark has been calculated showing the lowest risk level of borrowing. This 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 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 £10mn at each year-end to maintain sufficient liquidity but minimise credit risk.

2.9 The liability benchmark is an important tool to help establish whether the PCC is likely to be a long-term borrower or long-term investor in the future, and so shapes the strategic focus and decision making. The liability benchmark itself represents an estimate of the cumulative amount of external borrowing the PCC must hold to fund its current capital and revenue plans while keeping treasury investments at the minimum level required to manage day-to-day cash flow.

2.10 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.

2.11 In Appendix 1 Table 4, forecasts for CFR, net loans requirement and liability benchmark are shown against actual borrowing for 10 years.

2.12 The liability benchmark shows that there is a borrowing requirement from 2023/24 over the MTFP.

3.0 Borrowing Strategy

3.1 As at the 31 March 2022, the PCC held PFI loans totalling £22.415mn, £0.726mn of other long term loans, £13mn short term borrowing with Local Authorities and finance leases of £42k. The balance sheet forecast in Appendix 1 Table 2 shows that the PCC expects to borrow up to £50.159mn in 2023/24. The PCC may also borrow additional sums to pre-fund future years' requirements, providing this does not exceed the authorised limit for borrowing which is shown in Appendix 2 Table 11.

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's 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 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 2023/24 with a view to keeping future interest costs low, even if this causes additional cost in the short-term.

The PCC will consider PWLB as a source of borrowing as well as 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. The PWLB lending terms have been revised so that loans are no longer available to authorities that plan on buying investment assets primarily for yield. The PCC has no intention of undertaking this type of activity and so the access to PWLB loans is retained.

Alternatively, the PCC may arrange forward starting loans, 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:

- HM Treasury's PWLB lending facility (formerly the Public Works Loan Board)
- any institution approved for investments
- 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 Dorset Police Pension Fund)
- 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:

- leasing
- 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 issues bonds on the capital markets and lends the proceeds to local authorities. This is 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. The recent rise in interest rates means that more favourable debt rescheduling opportunities should arise than in previous years.

4.0 Investment Strategy

4.1 The PCC holds invested funds, representing income received in advance of expenditure plus balances and reserves held. This activity, plus the timing of borrowing decisions, lead to a cash surplus which is invested in accordance with the CIPFA guidance. In the first 7 months of 2022/23, the PCC's investment balance has ranged between £0.295mn and £24.950mn. These levels may reduce in the forthcoming year.

4.2 **Objectives:** The CIPFA Code and the MHCLG Guidance requires the PCC to invest its treasury 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 **Strategy:** As demonstrated by the liability benchmark above, the PCC expects to be a long-term borrower and new treasury investments will therefore be made primarily to manage day-to-day cash flows using short-term low risk instruments.

The CIPFA Code does not permit local authorities to both borrow and invest long-term for cash flow management. But the PCC may make long-term investments for treasury risk management purposes, including to manage interest rate risk by investing sums borrowed in advance for the capital programme for up to three years; to manage inflation risk by investing usable reserves in instruments whose value rises with inflation; and to manage price risk by diversifying.

4.4 **Environmental, social and governance (ESG):** considerations are increasingly a factor in global investors' decision making, but the framework for evaluating investment opportunities is still developing and therefore the PCC's ESG policy does not currently include ESG scoring or other real-time ESG criteria at an individual investment level.

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 to realise value from its internally managed treasury investments and uses two business models to achieve this. One collects contractual cashflows e.g. a bank notice account and the other covers non-contractual investments such as pooled funds which include money market funds. The accounting treatment is different for each model with an unusable reserve used to recognise fair value gains and losses for the latter model.

4.6 **Approved counterparties:** The PCC may invest its surplus funds with any of the counterparty types shown in Appendix 1 Table 5, subject to the cash and time limits. The PCC will invest with those counterparties recommended by Arlingclose and those that meet the required criteria outlined in this strategy.

4.7 **Minimum credit rating:** Treasury investments in the sectors marked with an asterisk in Table 5 will only be made with entities whose lowest published long-term credit rating is no lower than A-. 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.

For entities without published credit ratings, investments may be made only where external advice indicates the entity to be of similar credit quality.

4.8 **Banks and building societies (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 **Secured investments:** Investments secured on the borrower's assets, which limits the potential losses in the event of insolvency. The amount and quality of the security will be a key factor in the investment decision. Covered bonds and reverse repurchase agreements with banks and building societies 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. The combined secured and unsecured investments with any one counterparty will not exceed the cash limit for secured investments.

4.10 **Government:** Loans to, 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 Government are deemed to be zero credit risk due to its ability to create additional currency and therefore may be made in unlimited amounts for up to 50 years.

4.11 **Registered providers (unsecured):** Loans to, and bonds issued or guaranteed by, registered providers of social housing and registered social landlords, formerly known as housing associations. These bodies are 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.

4.12 **Money market funds:** Pooled funds that offer same-day or short notice liquidity and very low or no price volatility by investing in short term money markets. They have the advantage over bank accounts of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a small fee. Although no sector limit applies to money market funds, the PCC will take care to diversify its liquid investments over a variety of providers to ensure access to cash at all times.

4.13 **Strategic pooled funds:** 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 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, therefore where the credit rating falls below A- balances will be kept below £1.250mn, otherwise the standard counterparty limit will apply.

Where unscheduled income is received after the counterparty investment cut off times, the balance may exceed £1.250mn. The Treasury team will advise the Treasurer accordingly and ensure that the balance is brought back down to below £1.250mn the next working day.

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. The credit rating agencies in current use are listed in the Treasury Management Practices document. 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 "negative watch") 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 advisor. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may otherwise meet the above criteria.

When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008 and 2020, 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, or with other local authorities. This will cause investment returns to fall but will protect the principal sum invested.

4.17 **Investment limits**: The PCC's revenue reserves available to cover investment losses are forecast to be £9.117mn on 31 March 2023. The maximum that will be lent to any one organisation (other than the UK Government) is set out in Appendix 1 Table 5. A group of entities 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 and foreign countries. 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.

4.18 **Liquidity management**: The PCC uses a 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.

The PCC will spread its liquid cash over at least four providers to ensure that access to cash is maintained in the event of operational difficulties of any one provider.

4.19 Commercial Investments – Property: Seven properties were classed as investment properties as at 31 March 2022. When these properties were purchased, they were used as Police houses. These houses are now rented by local organisations and therefore are no longer operational assets. The netbook value of these properties was £2.106mn as at 31 March 2022 with an annual net income of £34k. The PCC has assessed the holding of these properties as low risk and if vacancies arise, the loss of income could be covered by the General reserve. At that point the properties would look to be sold, in order to generate a capital receipt. This could then be used to reduce future borrowing, and the associated revenue costs. The holding of these properties is a direct consequence of changes in use that have occurred rather than an investment decision targeted at achieving a return.

5.0 2018 MHCLG Investment Guidance

5.1 The contribution that Treasury Management Investments make to the objectives of the PCC 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 any new service or commercial 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, provide a financial guarantee to the APCC pension fund held by Merseyside LGPS amounting to £21k. If realised, the amounts would be covered by the General Fund Balance reserve.

6.0 Prudential Code 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, finance leases, Private Finance Initiative, other liabilities and cash flow requirements, and is a key management tool for in-year monitoring.

(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 Code Indicators

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

7.2 **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.

Credit risk indicator	Target
Portfolio average credit rating	A+

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

Liquidity risk indicator	Target
Minimum limit at less than 31 days duration	£3mn

7.4 **Interest rate exposures**: This indicator is set to control the PCC’s exposure to interest rate risk. The upper limits on the one year revenue impact of a 1% rise or fall in interest rates will be:

Interest rate risk indicator	Limit
Upper limit on 1 year revenue impact of a 1% rise in interest rates	(£200k)
Upper limit on 1 year revenue impact of a 1% fall in interest rates	£200k

The impact of a change to the variable interest rates is calculated on the assumption that maturing loans and investments will be replaced at new market rates.

It should be noted that all loan arrangements in place and those forecast have fixed interest rates and have been excluded from the calculations.

7.5 **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:

Refinancing rate risk indicator	Upper Limit	Lower Limit
Under 12 months	100%	0%
12 months and within 24 months	55%	0%
24 months and within 5 years	65%	0%
5 years and within 10 years	80%	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.

7.6 **Long-term treasury management investments:** 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 prudential limits on the long-term principal sum invested to final maturities beyond the period end will be:

Long term treasury management investments indicator	2023/24	2024/25	2025/26	No Fixed Date
Counterparty Limit on principal invested beyond year end	£3mn	£2.5mn	£2mn	£1.5mn

8.0 Other Items

8.1 The CIPFA Code requires the PCC to include the following 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.

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 receive 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 PCCs 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 three 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 4. 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 2018.

9.0 Financial Implications

9.1 The budget for investment income in 2023/24 is £160k, based on an average investment portfolio of £8mn at an average interest rate of 2%. The budget for debt interest payable in 2023/24 is £600k. 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 6.

Appendices

Appendix 1: Investment Strategy
Appendix 2: Prudential Indicators
Appendix 3: Interest Estimates
Appendix 4: Minimum Revenue Provision Statement
Appendix 5: Economic Context
Appendix 6: Governance
Appendix 7: Glossary

INVESTMENT STRATEGY **Appendix 1**

Table 1: Existing Investment and Debt Portfolio Position

Actual Portfolio as at 31/03/2022	
	£'000
External Borrowing:	
Short-term borrowing	(13,000)
Total External Borrowing	(13,000)
Other Long-Term Liabilities:	
Private Finance Initiative	(22,415)
Other long term liabilities	(726)
Total Other Long-Term Liabilities	(23,141)
Finance Leases	
Finance lease liabilities	(42)
Total Finance Leases	(42)
Total Gross External Debt	**(36,183)**
Treasury Investments:	
Short-term investments	3,992
Cash and cash equivalents	8,489
Total Treasury Investments	**12,481**
Net Debt	**(23,702)**

Table 2: Balance Sheet Summary and Forecast

	31/03/2022	31/03/2023	31/03/2024	31/03/2025	31/03/2026	31/03/2027
	Actual	Forecast	Estimate	Estimate	Estimate	Estimate
	£'000	£'000	£'000	£'000	£'000	£'000
Total Capital Financing Requirement	**30,864**	**37,109**	**50,159**	**50,460**	**48,866**	**47,417**
Less: PFI	(22,414)	(20,360)	(18,305)	(16,333)	(14,706)	(13,208)
Less: Other Long Term Liabilities	(727)	(607)	(489)	(382)	(275)	(167)
Less: External Borrowing for Capital	0	(8,885)	(24,795)	(28,306)	(30,279)	(32,392)
Less: Finance Leases	(42)	(12)	0	(88)	(58)	(28)
Internal Borrowing	**7,681**	**7,245**	**6,570**	**5,351**	**3,548**	**1,622**
Adjust for: Balance Sheet Resources						
Usable Reserves	(11,921)	(10,188)	(8,221)	(6,799)	(6,694)	(6,789)
Short Term Borrowing	(13,000)	0	0	0	0	0
Working Capital	4,759	5,500	4,744	4,744	4,744	4,812
Total Funds	**(20,162)**	**(4,688)**	**(3,477)**	**(2,055)**	**(1,950)**	**(1,977)**
New borrowing or (Treasury investments)	**(12,481)**	**2,557**	**3,093**	**3,296**	**1,598**	**(355)**

INVESTMENT STRATEGY **Appendix 1**

Table 3: Liability Benchmark

	31/03/2022	31/03/2023	31/03/2024	31/03/2025	31/03/2026	31/03/2027
	Actual	Forecast	Estimate	Estimate	Estimate	Estimate
	£'000	£'000	£'000	£'000	£'000	£'000
Total Capital Financing Requirement	**30,864**	**37,109**	**50,159**	**50,460**	**48,866**	**47,417**
Less: PFI	(22,414)	(20,360)	(18,305)	(16,333)	(14,706)	(13,208)
Less: Other Long Term Liabilities	(727)	(607)	(489)	(382)	(275)	(167)
Less: Finance Leases	(42)	(12)	0	(88)	(58)	(28)
Less: Short Term Borrowing for Cashflow	(13,000)	0	0	0	0	0
Borrowing	**(5,319)**	**16,130**	**31,365**	**33,657**	**33,827**	**34,014**
Less: Balance Sheet Resources	(7,162)	(4,688)	(3,477)	(2,055)	(1,950)	(1,977)
(Investments)/Borrowing	**(12,481)**	**11,442**	**27,888**	**31,602**	**31,877**	**32,037**

(Investments)/Borrowing	**(12,481)**	**11,442**	**27,888**	**31,602**	**31,877**	**32,037**
Plus: Liquidity Allowance	12,481	10,000	10,000	10,000	10,000	10,300
Total Borrowing Requirement	**0**	**21,442**	**37,888**	**41,602**	**41,877**	**42,337**

Net Loans Requirement (Investment less External Borrowing)	519	11,442	27,888	31,602	31,877	32,037
Plus: Liquidity Allowance	10,000	10,000	10,000	10,000	10,000	10,300
Liability Benchmark	**10,519**	**21,442**	**37,888**	**41,602**	**41,877**	**42,337**

INVESTMENT STRATEGY **Appendix 1**

Table 4: Liability Benchmark Chart

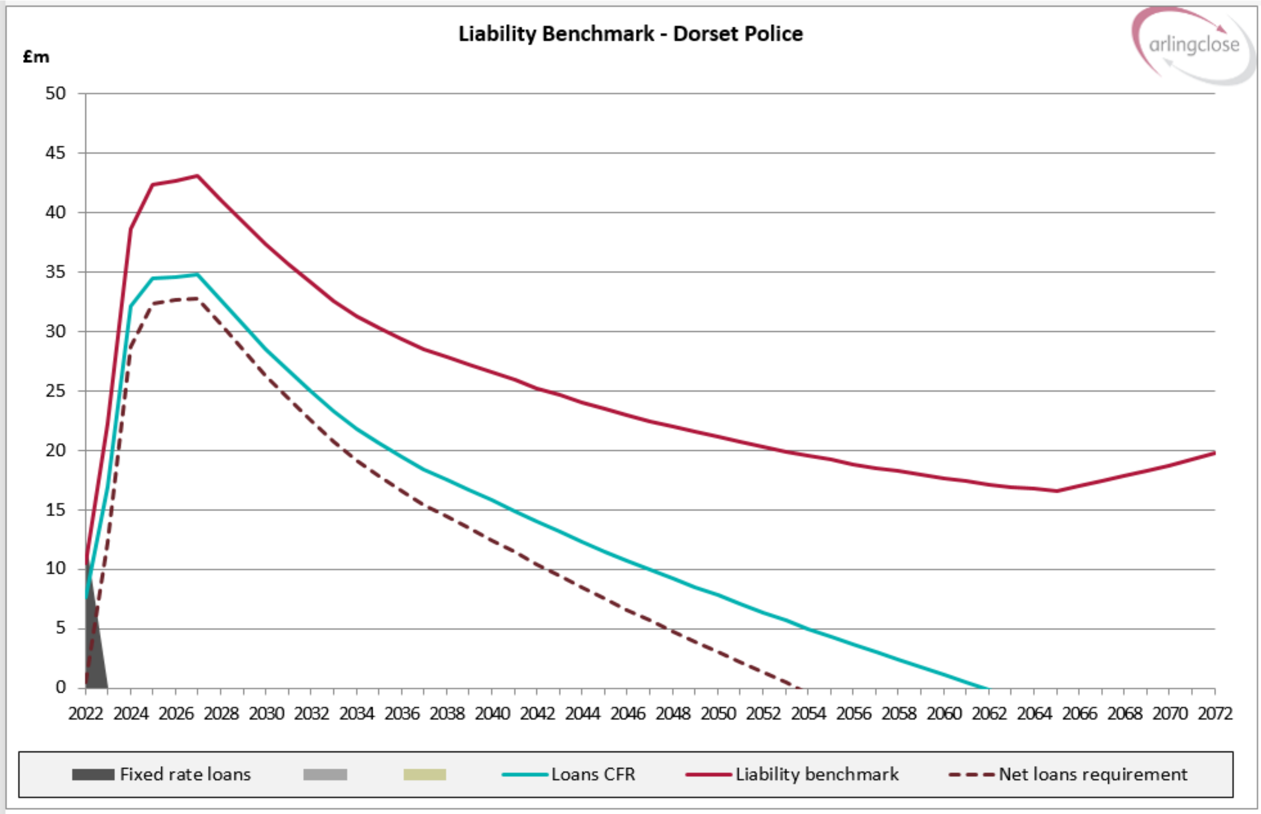

Table 5: Treasury Investment Counterparties and Limits

Sector	Time Limit	Counterparty Limit	Sector Limit
The UK Government	3 years	Unlimited	n/a
Local Authorities and Other Government Entities	3 years	£3mn	Unlimited
Secured Investments*	3 years	£3mn	Unlimited
Banks (unsecured)*	13 months	£1.5mn	Unlimited
Building Societies (unsecured)*	13 months	£1.5mn	£3mn
Registered Providers (unsecured)*	3 years	£1.5mn	£3mn
Money Market Funds (including Cash Plus Funds)*	n/a	£3mn	Unlimited
Strategic Pooled Funds**	n/a	£3mn	£4.7mn

*Please refer to the section on minimum credit rating.

**This sector limit is in line with the minimum level of reserves.

INVESTMENT STRATEGY **Appendix 1**

Table 6: Additional Investment Limits

	Cash Limit
Any group of Strategic Pooled Funds under the same management	£3mn per manager
Negotiable instruments held in a broker's nominee account	£7.5mn per broker
Foreign countries	£3mn per country

PRUDENTIAL INDICATORS **Appendix 2**

Table 7: Estimates of Capital Expenditure

	2021/22 Actual £'000	2022/23 Forecast £'000	2023/24 Estimate £'000	2024/25 Estimate £'000	2025/26 Estimate £'000	2026/27 Estimate £'000
Total Expenditure	**4,907**	**13,564**	**19,721**	**8,240**	**6,894**	**7,134**
Capital Grants	719	265	23	0	0	0
Capital Receipts	0	756	0	0	0	0
Earmarked Reserves	0	0	0	0	0	0
Revenue Contribution to Capital	2,523	3,658	3,288	4,229	4,421	4,521
Borrowing	1,665	8,885	16,410	4,011	2,473	2,613
Total Financing	**4,907**	**13,564**	**19,721**	**8,240**	**6,894**	**7,134**

Table 8: Estimates of Capital Financing Requirement

	2021/22 Actual £'000	2022/23 Forecast £'000	2023/24 Estimate £'000	2024/25 Estimate £'000	2025/26 Estimate £'000	2026/27 Estimate £'000
Opening CFR	**29,803**	**30,864**	**37,109**	**50,159**	**50,460**	**48,866**
Capital expenditure to be funded by borrowing	1,665	8,885	16,410	4,011	2,473	2,613
Capital expenditure to be funded by PFI	2,482	507	630	868	1,394	1,269
Finance Leases	0	0	0	118	0	0
Less: Minimum Revenue Provision	(216)	(435)	(675)	(1,219)	(1,803)	(1,927)
Less: External Borrowing Repayment	0	0	(500)	(500)	(500)	(500)
Less: PFI Repayment	(2,720)	(2,563)	(2,685)	(2,840)	(3,021)	(2,767)
Less: Other Long Term Liabilities Repayment	(120)	(119)	(118)	(107)	(107)	(107)
Less: Finance Leases Repayment	(30)	(30)	(12)	(30)	(30)	(30)
Closing CFR	**30,864**	**37,109**	**50,159**	**50,460**	**48,866**	**47,417**

PRUDENTIAL INDICATORS **Appendix 2**

Table 9: Gross Debt and the Capital Financing Requirement

	2021/22 Actual £'000	2022/23 Forecast £'000	2023/24 Estimate £'000	2024/25 Estimate £'000	2025/26 Estimate £'000	2026/27 Estimate £'000
PFI	22,414	20,360	18,305	16,333	14,706	13,208
Other Long Term Liabilities	727	607	489	382	275	167
External Borrowing	0	8,885	24,795	28,306	30,279	32,392
Finance Leases	42	12	0	88	58	28
Gross Debt	**23,183**	**29,864**	**43,589**	**45,109**	**45,318**	**45,795**
Internal Borrowing	7,681	7,245	6,570	5,351	3,548	1,622
Capital Financing Requirement	**30,864**	**37,109**	**50,159**	**50,460**	**48,866**	**47,417**

Table 10: Operational Boundary for External Debt

Operational Boundary	2021/22 Actual £'000	2022/23 Forecast £'000	2023/24 Estimate £'000	2024/25 Estimate £'000	2025/26 Estimate £'000	2026/27 Estimate £'000
PFI	22,414	20,360	18,305	16,333	14,706	13,208
Other Long Term Liabilities	727	607	489	382	275	167
External Borrowing	0	8,885	24,795	28,306	30,279	32,392
Finance Leases	42	12	0	88	58	28
Maximum forecast cashflow deficit arising from revenue budget operations	15,000	20,000	20,000	20,000	20,000	20,000
Total Operational Boundary	**38,183**	**49,864**	**63,589**	**65,109**	**65,318**	**65,795**

Table 11: Authorised Limit for External Debt

Authorised Limit	2021/22 Actual £'000	2022/23 Forecast £'000	2023/24 Estimate £'000	2024/25 Estimate £'000	2025/26 Estimate £'000	2026/27 Estimate £'000
Total Operational Boundary Debt	38,183	49,864	63,589	65,109	65,318	65,795
Additional margin for unforeseen circumstances/capital receipt	5,000	5,000	5,000	5,000	5,000	5,000
Total Authorised Limit	**43,183**	**54,864**	**68,589**	**70,109**	**70,318**	**70,795**

PRUDENTIAL INDICATORS **Appendix 2**

Table 12: Ratio of Financing Costs to Net Revenue Stream

	2021/22	2022/23	2023/24	2024/25	2025/26	2026/27
	Actual	Forecast	Estimate	Estimate	Estimate	Estimate
Ratio of Financing Costs to Net Revenue Stream	0.15%	0.31%	0.78%	1.36%	1.76%	1.81%

INTEREST ESTIMATES **Appendix 3**

Table 13: Interest Estimates

	2023/24
	£'000
Interest Income Estimate	(160)
Interest Payment Estimate	600

MINIMUM REVENUE PROVISION **Appendix 4**

Annual Minimum Revenue Provision Statement 2023/24

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 former Ministry of Housing, Communities and Local Government's (MHCLG) Guidance on Minimum Revenue Provision most recently issued in 2018. The broad aim of the MHCLG Guidance is to ensure that capital expenditure is financed 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 method will be reviewed to ensure its continued suitability. 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 2018 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 31 March 2023, the budget for MRP has been set as follows:

	2023/24 Estimated CFR	2023/24 Estimated MRP
	£'000	£'000
Unsupported capital expenditure after 31.03.2008	50,159	3,490

ECONOMIC CONTEXT **Appendix 5**

Arlingclose Economic Context as of 6 January 2023

Economic background: The ongoing impact on the UK from the war in Ukraine, together with higher inflation, higher interest rates, uncertain government policy, and a deteriorating economic outlook, will be major influences on the PCC's treasury management strategy for 2023/24.

The Bank of England (BoE) increased Bank Rate by 0.5% to 3.5% in December 2022. This followed a 0.75% rise in November which was the largest single rate hike since 1989 and the ninth successive rise since December 2021. The December decision was voted for by a 6-3 majority of the Monetary Policy Committee (MPC), with two dissenters voting for a no-change at 3% and one for a larger rise of 0.75%.

The November quarterly Monetary Policy Report (MPR) forecast a prolonged but shallow recession in the UK with CPI inflation remaining elevated at over 10% in the near-term. While the projected peak of inflation is lower than in the August report, due in part to the government's support package for household energy costs, inflation is expected remain higher for longer over the forecast horizon and the economic outlook remains weak, with unemployment projected to start rising.

The UK economy contracted by 0.3% between July and September 2022 according to the Office for National Statistics, and the BoE forecasts Gross Domestic Product (GDP) will decline 0.75% in the second half of the calendar year due to the squeeze on household income from higher energy costs and goods prices. Growth is then expected to continue to fall throughout 2023 and the first half of 2024.

CPI inflation is expected to have peaked at around 11% in the last calendar quarter of 2022 and then fall sharply to 1.4%, below the 2% target, in two years' time and to 0% in three years' time if Bank Rate follows the path implied by financial markets at the time of the November MPR (a peak of 5.25%). However, the BoE stated it considered this path to be too high, suggesting that the peak in interest rates will be lower, reducing the risk of inflation falling too far below target. Market rates have fallen since the time of the November MPR.

The labour market remains tight for now, with the most recent statistics showing the unemployment rate was 3.7%. Earnings were up strongly in nominal terms by 6.1% for both total pay and for regular pay but factoring in inflation means real pay for both measures was -2.7%. Looking forward, the November MPR shows the labour market weakening in response to the deteriorating outlook for growth, leading to the unemployment rate rising to around 6.5% in 2025.

Interest rates have also been rising sharply in the US, with the Federal Reserve increasing the range on its key interest rate by 0.5% in December 2022 to 4.25%-4.5%. This rise follows four successive 0.75% rises in a pace of tightening that has seen rates increase from 0.25%-0.50% in March 2022. Annual inflation has been slowing in the US but remains above 7%. GDP grew at an annualised rate of 3.2% (revised up from 2.9%) between July and September 2022, but with official interest rates expected to rise even further in the coming months, a recession in the region is widely expected at some point during 2023.

Inflation rose consistently in the Euro Zone since the start of the year, hitting a peak annual rate of 10.6% in October 2022, before declining to 10.1% in November. Economic growth has been weakening with an upwardly revised expansion of 0.3% (from 0.2%) in the three months to September 2022. As with the UK and US, the European Central Bank has been on an interest rate tightening cycle, pushing up its three key interest rates by 0.50% in December, following two consecutive 0.75% rises, taking its main refinancing rate to 2.5% and deposit facility rate to 2.0%.

Credit outlook:

Credit default swap (CDS) prices have generally followed an upward trend throughout 2022, indicating higher credit risk. They have been boosted by the war in Ukraine, increasing economic and political uncertainty and a weaker global and UK outlook, but remain well below the levels seen at the beginning of the Covid-19 pandemic.

CDS price volatility was higher in 2022 compared to 2021 and the divergence in prices between ringfenced (retail) and non-ringfenced (investment) banking entities has emerged once again.

The weakening economic picture during 2022 led the credit rating agencies to reflect this in their assessment of the outlook for the UK sovereign as well as several local authorities and financial institutions, revising them from to negative from stable.

There are competing tensions in the banking sector which could impact bank balance sheet strength going forward. The weakening economic outlook and likely recessions in many regions increase the possibility of a deterioration in the quality of banks' assets, while higher interest rates provide a boost to net income and profitability.

However, the institutions on our adviser Arlingclose's counterparty list remain well-capitalised and their counterparty advice on both recommended institutions and maximum duration remain under constant review and will continue to reflect economic conditions and the credit outlook.

Interest rate forecast (December 2022):

The PCC's treasury management adviser Arlingclose forecasts that Bank Rate will continue to rise in 2022 and 2023 as the Bank of England attempts to subdue inflation which is significantly above its 2% target.

ECONOMIC CONTEXT **Appendix 5**

While interest rate expectations reduced during October and November 2022, multiple interest rate rises are still expected over the forecast horizon despite looming recession. Arlingclose expects Bank Rate to rise to 4.25% by June 2023 under its central case, with the risks in the near- and medium-term to the upside should inflation not evolve as the Bank forecasts and remains persistently higher.

Yields are expected to remain broadly at current levels over the medium-term, with 5-, 10- and 20-year gilt yields expected to average around 3.5%, 3.5%, and 3.85% respectively over the 3-year period to December 2025. The risks for short, medium and longer-term yields are judged to be broadly balanced over the forecast horizon. As ever, there will undoubtedly be short-term volatility due to economic and political uncertainty and events.

Underlying assumptions (December 2022):

- The influence of the mini-budget on rates and yields continues to wane following the more responsible approach shown by the new incumbents of Downing Street.
- Volatility in global markets continues, however, as investors seek the extent to which central banks are willing to tighten policy, as evidence of recessionary conditions builds. Investors have been more willing to price in the downturn in growth, easing financial conditions, to the displeasure of policymakers. This raises the risk that central banks will incur a policy error by tightening too much.
- The UK economy is already experiencing recessionary conditions and recent GDP and PMI data suggests the economy entered a technical recession in Q3 2022. The resilience shown by the economy has been surprising, despite the downturn in business activity and household spending. Lower demand should bear down on business pricing power – recent data suggests the UK has passed peak inflation.
- The lagged effect of the sharp tightening of monetary policy, and the lingering effects of the mini-budget on the housing market, widespread strike action, alongside high inflation, will continue to put pressure on household disposable income and wealth. The short- to medium-term outlook for the UK economy remains bleak.
- Demand for labour appears to be ebbing, but not quickly enough in the official data for most MPC policymakers. The labour market remains the bright spot in the economy and persisting employment strength may support activity, although there is a feeling of borrowed time. The MPC focus is on nominal wage growth, despite the huge real term pay cuts being experienced by the vast majority. Bank Rate will remain relatively high(er) until both inflation and wage growth declines.
- Global bond yields remain volatile as investors price in recessions even as central bankers push back on expectations for rate cuts in 2023. The US labour market remains tight and the Fed wants to see persistently higher policy rates, but the lagged effects of past hikes will depress activity more significantly to test the Fed's resolve.

ECONOMIC CONTEXT **Appendix 5**

- While the BoE appears to be somewhat more dovish given the weak outlook for the UK economy, the ECB seems to harbour (worryingly) few doubts about the short term direction of policy. Gilt yields will be broadly supported by both significant new bond supply and global rates expectations due to hawkish central bankers, offsetting the effects of declining inflation and growth.

Forecast:

- The MPC raised Bank Rate by 50bps to 3.5% in December as expected, with signs that some members believe that 3% is restrictive enough. However, a majority of members think further increases in Bank Rate might be required. Arlingclose continues to expect Bank Rate to peak at 4.25%, with further 25bps rises February, March and May 2023.
- The MPC will cut rates in the medium term to stimulate a stuttering UK economy, but will be reluctant to do so until wage growth eases. We see rate cuts in the first half of 2024.
- Arlingclose expects gilt yields to remain broadly steady over the medium term, although with continued volatility across shorter time periods.
- Gilt yields face pressures to both sides from hawkish US/EZ central bank policy on one hand to the weak global economic outlook on the other. BoE bond sales and high government borrowing will provide further underlying support for yields.

	Current	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25
Official Bank Rate													
Upside risk	0.00	0.50	0.75	1.00	1.00	1.00	1.25	1.50	1.75	1.50	1.25	1.25	1.25
Arlingclose Central Case	**3.50**	**4.00**	**4.25**	**4.25**	**4.25**	**4.25**	**4.00**	**3.75**	**3.50**	**3.25**	**3.25**	**3.25**	**3.25**
Downside risk	0.00	0.50	0.75	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.00	1.00
3-month money market rate													
Upside risk	0.00	0.50	0.75	1.00	1.00	1.00	1.25	1.50	1.75	1.50	1.25	1.25	1.25
Arlingclose Central Case	**3.00**	**4.40**	**4.40**	**4.40**	**4.35**	**4.30**	**4.25**	**4.00**	**3.75**	**3.50**	**3.40**	**3.40**	**3.40**
Downside risk	0.00	0.50	0.75	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.00	1.00
5yr gilt yield													
Upside risk	0.00	0.70	0.80	0.90	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Arlingclose Central Case	**3.43**	**3.60**	**3.80**	**3.80**	**3.80**	**3.70**	**3.60**	**3.50**	**3.40**	**3.30**	**3.30**	**3.30**	**3.30**
Downside risk	0.00	0.80	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
10yr gilt yield													
Upside risk	0.00	0.70	0.80	0.90	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Arlingclose Central Case	**3.47**	**3.50**	**3.60**	**3.60**	**3.60**	**3.60**	**3.50**	**3.50**	**3.50**	**3.50**	**3.50**	**3.50**	**3.50**
Downside risk	0.00	0.80	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
20yr gilt yield													
Upside risk	0.00	0.70	0.80	0.90	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Arlingclose Central Case	**3.86**	**3.85**	**3.85**	**3.85**	**3.85**	**3.85**	**3.85**	**3.85**	**3.85**	**3.85**	**3.85**	**3.85**	**3.85**
Downside risk	0.00	0.80	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
50yr gilt yield													
Upside risk	0.00	0.70	0.80	0.90	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Arlingclose Central Case	**3.46**	**3.60**	**3.60**	**3.60**	**3.60**	**3.60**	**3.60**	**3.60**	**3.60**	**3.60**	**3.60**	**3.60**	**3.60**
Downside risk	0.00	0.80	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00

PWLB Standard Rate (Maturity Loans) = Gilt yield + 1.00%
PWLB Certainty Rate (Maturity Loans) = Gilt yield + 0.80%
UKIB Rate (Maturity Loans) = Gilt yield + 0.60%

GOVERNANCE **Appendix 6**

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.

GLOSSARY **Appendix 7**

Annuity	A method of repaying a loan where the cash payment remains constant over the life of the loan, but the proportion of interest reduces and the proportion of principal repayment increases over time. Repayment mortgages and personal loans tend to be repaid by the annuity method.
Authorised limit	The maximum amount of *debt* that a local authority may legally hold, set annually in advance by the authority itself. One of the *Prudential Indicators*.
Bail-in	A method of rescuing a failing *financial institution* by cancelling some of its *deposits* and *bonds*. Investors may suffer a *haircut* but may be given *shares* in the bank as part compensation.
Bank	Regulated firm that provides financial services to customers. But see also *Bank of England*.
Bank of England	The *central bank* of the UK, based in London, sometimes just called "the Bank". See also *Monetary Policy Committee.*
Bank Rate	The official interest rate set by the *Monetary Policy Committee*, and the rate of interest paid by the *Bank of England* on commercial bank deposits. Colloquially termed the "base rate".
Bid	A bid to buy a *security* at a certain price (the bid price), or a bid to borrow money at a certain interest rate (the bid rate).
Bill	A certificate of *short-term* debt issued by a company, government, or other institution, which is tradable on financial markets
Bond	A certificate of *long-term* debt issued by a company, government, or other institution, which is tradable on financial markets.
Borrowing	Usually refers to the stock of outstanding loans owed and *bonds* issued.
Broker	Regulated firm that matches either borrowers and lenders (a money broker) or buyers and sellers of *securities* (a stockbroker) with each other in order to facilitate transactions.
Building society	A mutual organisation that performs similar functions to a *retail bank* but is owned by its customers.
Capital	**(1)** Long-term, as in *capital expenditure* and *capital receipt.* **(2)** Principal, as in *capital gain* and capital value. **(3)** Investments in *financial institutions* that will absorb losses before *senior unsecured creditors.*
Capital expenditure	Expenditure on the acquisition, creation or enhancement of fixed assets that are expected to provide value for longer than one year, such as property and equipment, plus expenditure defined as capital in legislation such as the purchase of certain investments.
Capital finance	Arranging and managing the cash required to finance *capital expenditure*, and the associated accounting.
Capital financing requirement (CFR)	A local authority's underlying need to hold debt for capital purposes, representing the cumulative capital expenditure that has been incurred but not yet financed. The CFR increases with *capital expenditure* and decreases with *capital finance* and *MRP*.
Capital markets	The markets for long-term finance, including *bonds* and *shares*. See also *money markets*.

GLOSSARY **Appendix 7**

Capital receipt	Cash obtained from the sale of an item whose purchase would be *capital expenditure*. The law only allows local authorities to spend capital receipts on certain items, such as new capital expenditure. They are therefore held in a capital receipts reserve until spent.
Cash plus fund	A *pooled fund is* similar to a *money market fund* but with a *WAM* up to around six months.
Central bank	A government agency responsible for setting interest rates, regulating banks and maintaining financial stability.
Certificate of deposit (CD)	A short-term *debt* instrument, similar to a *deposit*, but that is tradable on the *money markets*.
CIPFA	The Chartered Institute of Public Finance and Accountancy - the professional body for accountants working in the public sector. CIPFA also sets various standards for local government.
Commercial investment	An investment whose main purpose is generating income, such as *investment property*.
Cost of carry	When a loan is borrowed in advance of need, the difference between the interest payable on the loan and the income earned from investing the cash in the interim.
Counterparty	The other party to a loan, investment or other contract.
Counterparty limit	The maximum amount an investor is willing to lend to a *counterparty*, in order to manage *credit risk*.
Covered bond	*Bond* issued by a *financial institution* that is secured on that institution's assets, usually residential mortgages, and is therefore lower risk than unsecured bonds. Covered bonds are exempt from *bail-in*.
CPI	Consumer Price Index - the measure of inflation targeted by the *Monetary Policy Committee*, measured on a harmonised basis across the European Union.
Credit default swap (CDS)	*Derivative* for swapping *credit risk* on a particular issuer, similar to an insurance policy where the buyer pays a *premium* against the risk of default. Also used as an indicator of credit risk: the higher the premium, the higher the perceived risk.
Credit rating	Formal opinion by a *credit rating agency* of a *counterparty*'s future ability to meet its financial obligations. As it is only an opinion, there is no guarantee that a highly rated organisation will not default.
Credit rating agency	An organisation that publishes *credit ratings*. The three largest agencies are Fitch, Moody's and Standard & Poor's but there are many smaller ones.
Credit risk	The risk that a *counterparty* will *default* on its financial obligations.
Debt	**(1)** A contract where one party owes money to another party, such as a *loan*, *deposit* or *bond*. Contrast with *equity*. **(2)** In the *Prudential Code*, the total outstanding *borrowing* plus *other long-term liabilities.*
Default	Failure to meet an obligation under a debt contract, including the repayment of cash or compliance with a *covenant*, usually as a result of being in financial difficulty (rather than an administrative oversight).

GLOSSARY **Appendix 7**

Deflation	Negative inflation, which central banks are keen to avoid since households tend to delay spending waiting for prices to fall further, leading to further deflation.
Deposit	A regulated placing of cash with a *financial institution*. Deposits are not tradable on financial markets.
Derivative	Financial instrument whose value is derived from an underlying instrument or index, such as a *swap*, *option* or *future*. Derivatives can be used to gain exposure to, or to help protect against, changes in the value of the underlying.
Discount	**(1)** The amount that the early repayment cost of a loan is below its principal, or the price of a bond is below its nominal value. **(2)** To calculate the *present value* of an investment taking account of the time value of money.
Diversification	The spreading of risk across a variety of exposures in order to reduce the risk. For example, investing in a range of *counterparties* to limit *credit risk* or borrowing to a range of *maturity* dates to limit *refinancing risk*.
Duration	In relation to a *bond* or *bond fund*, the weighted average time of the future cash flows from today, usually expressed in years. The longer the duration, the more the price moves for a given change in interest rates.
ECB	European Central Bank – the *central bank* of the Eurozone, based in Frankfurt, Germany.
Embedded derivative	A *derivative* that is combined into another financial instrument, such as the *options* embedded in a *LOBO*.
Equity	**(1)** The residual value of an entity's assets after deducting its liabilities. **(2)** An investment in the residual value of an entity, for example ordinary shares.
Fair value	*IFRS* term for the price that would be obtained by selling an investment, or paid to transfer debt, in a market transaction.
Federal Reserve	The *central bank* of the USA, often just called "the Fed".
Financial instrument	*IFRS* term for investments, borrowing and other cash payable and receivable.
Financing costs	In the *Prudential Code*, interest payable on *debt* less investment income plus *premiums* less *discounts* plus *MRP*.
Future	A *derivative* whose payments depend on the future value of a variable.
Fund manager	Regulated firm that manages *pooled funds*.
GDP	Gross domestic product – the value of the national aggregate production of goods and services in the economy. Increasing GDP is known as economic growth.
General Fund	A local authority reserve that holds the accumulated surplus or deficit on revenue income and expenditure, except on council housing.
Gilt	Bond issued by the UK Government, taking its name from the gilt-edged paper they were originally printed on.
Gilt yield	*Yield* on *gilts*. Commonly used as a measure of risk-free long-term interest rates in the UK.
Guarantee	An arrangement where a third party agrees to pay the contractual payments on a *loan* to the lender if the borrower *defaults*.

GLOSSARY **Appendix 7**

IFRS	International Financial Reporting Standards, the set of accounting rules in use by UK local authorities since 2010.
Impairment	A reduction in the value of an investment caused by the *counterparty* being in financial difficulty.
Interest	Compensation for the use of cash paid by borrowers to lenders on *debt* instruments.
Interest rate risk	The risk that unexpected changes in interest rates cause an unplanned loss, for example by increased payments on borrowing or lower income on investments.
Internal borrowing	A local government term for when actual "external" *debt* is below the *capital financing requirement*, indicating that difference has been borrowed from internal resources instead; in reality this is not a form of borrowing.
Investment guidance	Statutory guidance issued by MHCLG and the devolved governments on local government investments. Local authorities are required by law to have regard to the relevant investment guidance.
Investment strategy	A document required by *investment guidance* that sets out a local authority's investment plans and parameters for the coming year. Sometimes forms part of the authority's *treasury management strategy*.
Lease	A contract where one party permits another to make use of an asset in return for a series of payments. It is economically similar to buying the asset and borrowing a loan, and therefore leases are often counted as a type of *debt*.
Liability benchmark	Term in CIPFA's Risk Management Toolkit which refers to the minimum amount of borrowing required to keep investments at a minimum liquidity level. Used to compare against the actual and forecast level of borrowing.
Loan	Contract where the lender provides a sum of money (the *principal*) to a borrower, who agrees to repay it in the future together with *interest*. Loans are not normally tradable on financial markets. There are specific definitions in government *investment guidance*.
Long-term	Usually means longer than one year.
Maturity	**(1)** The date when an investment or borrowing is scheduled to be repaid. **(2)** A type of loan where the principal is only repaid on the maturity date.
MHCLG	Ministry of Housing, Communities and Local Government – the central government department that oversees local authorities in England.
Monetary policy	Measures taken by *central banks* to boost or slow the economy, usually via changes in interest rates. Monetary easing refers to cuts in interest rates, making it cheaper for households and businesses to borrow and hence spend more, boosting the economy, while monetary tightening refers to the opposite.
Monetary Policy Committee (MPC)	Committee of the *Bank of England* responsible for implementing *monetary policy* in the UK by changing *Bank Rate* and *quantitative easing* with the aim of keeping *CPI* inflation at around 2%.
Money market fund (MMF)	A *pooled fund* which invests in a range of short-term assets providing high credit quality and high liquidity. Usually refers to *CNAV* and *LVNAV* funds with a *WAM* under 60 days which offer instant access, but the European Union definition extends to include *cash plus funds*.
Money markets	The markets for short-term finance, including *deposits* and *T-bills*.

GLOSSARY **Appendix 7**

MRP	Minimum revenue provision **- a**n annual amount that local authorities are required to set aside and charge to revenue for the repayment of debt associated with capital expenditure. Local authorities are required by law to have regard to government guidance on MRP.
Municipal bond	*Bond* issued or guaranteed by local authorities.
Municipal bonds agency	Company that issues *bonds* in the *capital market* and lends the proceeds back to local authorities. The bonds are guaranteed by the local authorities.
Net borrowing	*Borrowing* minus *treasury investments*.
Net revenue stream	In the *Prudential Code*, income from general government grants, Council Tax and rates.
Notice account	A *deposit* account where the cash can be called back after a given notice period.
Other long-term liabilities	*Prudential Code* term for *credit arrangements*.
Operational boundary	A *prudential indicator* showing the most likely, prudent, estimated level of external *debt*, but not the worst-case scenario. Regular breaches of the operational boundary should prompt management action.
Option	A *derivative* where the holder pays a *premium* to have the right, but not the obligation, to buy or sell a security or enter into a defined transaction.
Outlook	A *credit rating agency's* expected direction of travel in the *long-term rating* over the next two years.
Pension Fund	Ringfenced account for the income, expenditure and investments of the local government pension scheme. Pension fund investments are not considered to be part of *treasury management*.
Pooled fund	Scheme in which multiple investors collectively hold units or shares. The investment assets in the fund are not held directly by each investor, but as part of a pool (hence these funds are also referred to as 'pooled funds').
Premium	**(1)** The amount that the early repayment cost of a loan is above the principal, or the price of a bond is above its nominal value. **(2)** The initial payment made under a *derivative*.
Principal	The amount of money originally lent on a *debt* instrument.
Private Finance Initiative (PFI)	A government scheme where a private company designs, builds, finances and operates assets on behalf of the public sector, in exchange for a series of payments, typically over 30 years. Counts as a *credit arrangement* and *debt.*
Property fund	A *pooled fund* that mainly invests in property. Due to the costs of buying and selling property, including *stamp duty land tax*, there is usually a significant fee charged on initial investment, or a significant difference between the *bid* and *offer* price.
Prudential Code	Developed by CIPFA and introduced in April 2004 as a professional code of practice to support local authority capital investment planning within a clear, affordable, prudent and sustainable framework and in accordance with good professional practice. Local authorities are required by law to have regard to the Prudential Code.
Prudential indicators	Indicators required by the *Prudential Code* and determined by the local authority to define its capital expenditure and asset management framework. They are designed to support and record local decision making in a manner that is publicly accountable.

GLOSSARY **Appendix 7**

PWLB	Public Works Loans Board - a statutory body operating within the *DMO* that lends money from the National Loans Fund to local authorities and other prescribed bodies and collects the repayments. Not available in Northern Ireland.
Redemption	The process of withdrawing cash from a *pooled fund* and cancelling the units of shares. Redemptions can be suspended in certain circumstances detailed in the *prospectus*.
Refinancing risk	The risk that maturing loans cannot, be refinanced, or only at higher than expected interest rates leading to an unplanned loss. Managed by maintaining a smooth *maturity profile*.
Registered Provider of Social Housing (RP)	An organisation that is registered to provide social housing, such as a housing association. Also known as a registered social landlord or RSL.
Sector limit	The maximum amount an investor is willing to lend to all *counterparties* in a particular industry sector, in order to manage *credit risk*.
Security	**(1)** A *financial instrument* that can be traded on a *secondary market.* **(2)** The concept of low *credit risk.* **(3)** *Collateral.*
Secured investment	An investment that is backed by *collateral* and is therefore normally lower *credit risk* and lower yielding than an equivalent unsecured investment.
Service investments	Investments made to promote a local authority's public service objectives, for example a *loan* to a local charity or *shares* in a local company.
Share	An *equity* investment, which usually also confers ownership and voting rights.
Short-term	Usually means less than one year.
Swap	A *derivative* where the *counterparties* exchange cash flows, for example fixed rate interest and variable rate interest.
Total return	The overall return on an investment, including *interest*, *dividends*, *rent*, fees and *capital gains and losses*.
Treasury bill	Treasury bill - a *bill* issued by a government.
Treasury investments	Investments made for *treasury management* purposes, as opposed to *commercial investments* and *service investments*.
Usable reserves	Resources available to finance future *revenue* and/or *capital expenditure.* Some usable reserves are ringfenced by law for certain expenditure such as on schools or council housing.
Volatility	A measure of the variability of a price or index, usually expressed as the annualised standard deviation.
Working capital	The cash surplus or deficit arising from the timing differences between income/expenditure in accounting terms and receipts/payments in cash terms.
Yield	A measure of the return on an investment, especially a *bond*. The yield on a fixed rate bond moves inversely with its price.