Appendix 3

TREASURY MANAGEMENT – INVESTMENT STRATEGY

1. Introduction

1.1 Treasury Management is defined as the management of the Police and Crime Commissioner's (PCC) investments and cash flows, banking and financing of capital expenditure; the effective control of the risks associated with those activities, balanced against the relative performance.

1.2 A key activity of Treasury Management is to ensure that the cash flow is adequately planned, with cash being available when it is needed. Any surplus funds are invested in low risk counterparties in line with the strategy of providing security of the capital and sufficient liquidity before investment return.

1.3 Capital financing decisions provide a guide to the borrowing need of the PCC, essentially the longer term cash flow planning to ensure that the capital spending obligations can be met. The management of the longer term cash balances may involve arranging long or short term loans, or using longer term cash flow surpluses. On occasions any current loans may be restructured to meet the PCCs risk or cost objectives.

2. Statutory Requirements

2.1 The 'Code of Treasury Management' published by the Chartered Institute of Public Finance and Accountancy (CIPFA), and recommended by the Home Office, has been adopted by the Office of the Police and Crime Commissioner for Leicestershire ("the OPCC").

2.2 In addition, the Department for Communities and Local Government (CLG) issued revised guidance on Local Authority investments in March 2010 that requires the PCC to approve an investment strategy before the start of each financial year.

2.3 This report fulfils the OPCC's legal obligations under the Local Government Act 2003 to have regard to both the CIPFA Code and CLG guidance.

2.4 The Treasury Management Strategy is approved annually to run from 1st April to the following 31st March.

2.5 The Local Government Act 2003 included capital regulations that applied from 1st April 2004. These regulations allow the OPCC freedom to borrow to fund capital expenditure provided it has plans that are affordable, prudent and sustainable. The requirements are covered in the Prudential Code.

3. Treasury Management Strategy

3.1 The OPCC has potentially large exposure to financial risks including the loss of invested funds and the effect of changing interest rates. The successful identification, monitoring and control risk is therefore central to the OPCC's treasury management strategy

3.2 Uncertainty in the financial markets is likely to continue during 2018/19 as the UK's progress in negotiating a smooth exit from the European Union and the single market continues. The consumer price inflation (CPI) index rose during 2017/18 and the Bank of England responded with a Bank of England interest rate increase of 0.25% in November 2017.

3.3 This has resulted in a minor increase in the interest rates available when investing surplus funds.

3.4 The core aim of the Treasury Management Strategy is to generate additional income for the OPCC but by balancing risk against return. The avoidance of risk to the principal cash amounts takes precedence over maximising returns.

3.5 Managing daily cash balances and investing surpluses

In order that the OPCC can maximise income earned from investments, the target for the uninvested overnight balance in the current account is a maximum of £15k.

At any one time, the OPCC has between £7m and £25m (depending on the cash flow) available to invest. This represents income received in advance of expenditure plus balances and reserves.

Currently most of the PCC's surplus cash is invested in short term unsecured bank deposits and money market funds.

In order to minimise exposure to credit risk, a minimum credit quality of counterparties for inclusion in the lending list is set.

The current lending list is as follows:-

Institution	Maximum Loan £m	Maximum Period of Loan	Short-Term Credit Ratings **
Royal Bank of Scotland plc	10.0	364 days	F2 / A-3 / P-3
Lloyds Bank plc	10.0	364 days	F1 / A-2 / P-2
Barclays Bank plc	10.0	364 days	F1 / A-1 / P-1
HSBC Bank plc	10.0	364 days	F1+ / A-1+ / P-1
Nationwide Building Society	10.0	364 days	F1 / A-1 / P-1
Debt Management Office	*	364 days	n/a

* No limit is set. The DMO tends to pay a low rate of return and hence are used only when funds can not be placed with other approved institutions.
** Short-term credit ratings (valid as at 12/01/2018) are as supplied by the OPCC's brokers - Tullet Prebon (Europe) Ltd. The highest potential ratings are F1+ (Fitch), A-1+ (Standard & Poor's) and P-1 (Moody's) respectively.

3.6 Borrowing

The OPCC currently holds £13.3m of loans. The amount is split between the Public Works Loans Board (PWLB) figure of £12.4m and Leicestershire

County Council £0.9m (transferred debt from 1995 regarding the formation of police authorities as per the Police and Magistrates Courts Act 1994. This has now transferred to the OPCC).

The main objective when borrowing funds is strike a balance between securing low interest costs and achieving certainty of those costs over the period for which the funds are required.

The strategy continues to address the key issues of affordability. With short-term interest rates currently lower than long term rates, it is likely to be more effective in the short-term to either use internal resources, or to borrow short-term loans instead.

By borrowing internally, the OPCC is able to reduce net borrowing costs (despite forgone investment income) and reduce overall treasury risk. The benefits of internal versus external borrowing will continue to be monitored.

In addition, the OPCC may borrow short term loans to cover unplanned cash flow shortages.

The recommended sources of long-term and short-term borrowing are:

- Public Works Loan Board (PWLB)
- UK Local Authorities
- Any other bank or building society authorised to operate in the UK

Whilst the OPCC has previously raised all of its long term borrowing from the PWLB other options will be explored at the point of borrowing to ensure that the most favourable rates are secured.

Short term and variable rate loans can leave the OPCC exposed to the risk of short term interest rate rises and are therefore subject to the limit on the net exposure to variable interest rates in the Treasury Management Indicators

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. The current loan portfolio will be reviewed during 2018/19 to see whether a saving could be achieved on the overall interest costs.

The PCC will not borrow more than or in advance of his needs purely in order to profit from the investment of extra sums borrowed. Any decision to borrow in advance will be within the forward approved Capital Financing Requirement estimates and will be considered carefully to ensure value for money can be demonstrated and the PCC can ensure the security of such funds.

4. Latest Position regarding Treasury Management

4.1 The banking sector continues to show signs of instability alongside the wider economy. In this context it is not yet advisable to consider a return to placing investments with the majority of Building Societies or European/Foreign banks. This is in keeping with the OPCC's stated aim of protecting the principal (cash) amount.

4.2 Funds are placed with institutions based on (a) available headroom and (b) rate of return – this is a daily decision-making process. A balance is struck between the desired level of return and the need to provide liquid funds to meet the OPCC's obligations i.e. supplier payments, payroll costs and tax liabilities.

4.3 Continued monitoring of the ratings agencies' assessment of institutions takes place and is reported to SAB throughout the year via the "Treasury Management Performance" report.

4.4 The Bank of England Base raised interest rates from 0.25% to 0.5% in November 2017 with the future outlook for a further 2 increases over the next 3 years. On this basis the investment income budget Rate has been set at £65k for 2018/19.

Financial Year	Interest Income	Comments
2015/16	£0.09m	Actual
2016/17	£0.07m	Actual
2017/18	£0.05m	Forecast
2018/19	£0.06m	Proposed Budget

4.5 Given the continued uncertainty in the economy a full review of the Treasury Management Strategy will be undertaken during 2018/19 to review whether there are other investment options available.

5. External Advice

5.1 External advisers have not been used over the last year. However they may be used on an ad-hoc basis if required.

6. Treasury Management Indicators

6.1 The OPCC measures and manages its exposures to treasury management risks using the following indicators.

7. Borrowing Limits

7.1 In accordance with the Prudential Code it is a requirement that the OPCC set borrowing limits for the next 3 years and an upper limits on fixed and variable interest rate exposures, expressed as the amount of principal borrowed or invested will be. These limits are intended to reduce risk. It is proposed that the limits should be as follows:

		2017/18 £m	2018/19 £m	2019/20 £m	2020/21 £m
(i)	Total authorised borrowing limit*	24.4	25.8	28.6	29.7
(ii)	Long term liabilities	1.4	1.0	0.5	0.5
(iii)	Interest payable limit on borrowing at variable rates	0.2	0.2	0.3	0.3
(iv)	Interest payable limit on borrowing at fixed rates	0.6	0.7	0.8	0.9

* includes headroom for short term borrowing - £1m for each year.

7.2 The Prudential Code also recommends that the Police and Crime Commissioner sets upper and lower limits for the maturity structure of its fixed rate borrowing to control exposure to refinancing risk.. The following limits are proposed:-

	Upper Limit	Lower Limit
Under 12 months	20%	0%
Between 12 months and 24 months	20%	0%
Between 24 months and 5 years	20%	0%
Between 5 years and 10 years	50%	0%
Over 10 years	100%	25%

7.3 No investments are made for more than 365 days.