North Wales Police and Crime Commissioner Capital Strategy Report 2023/24

1. Introduction

1.1. This capital strategy report gives a high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of local public services along with an overview of how associated risk is managed and the implications for future financial sustainability. It has been written in an accessible style to enhance members' understanding of these sometimes-technical areas.

1.2. Decisions made this year on capital and treasury management will have financial consequences for the Police and Crime Commissioner for many years into the future. They are therefore subject to both a national regulatory framework and to local policy framework, summarised in this report.

2. Capital Expenditure and Financing

2.1. Capital expenditure is where the Police and Crime Commissioner spends money on assets, such as property or vehicles, that will be used for more than one year. In local government this includes spending on assets owned by other bodies, and loans and grants to other bodies enabling them to buy assets.

2.2. The draft Capital Programme was presented to the Strategic Executive Board (SEB) on 15 February 2023 as part of the Medium-Term Financial Plan and agreed subject to the final ratification of this Capital Strategy. A further exercise has been undertaken to re-assess the phasing of individual capital projects which has resulted in a change in the timing of the projects but not a significant change in the overall costs. The Police and Crime Commissioner is planning capital expenditure as summarised below, with details as shown in **Appendix A**:

Table 1: Prudential Indicator: Estimates of Capital Expenditure in £ millions

	2021/22 actual £m	2022/23 forecast £m	2023/24 budget £m	2024/25 budget £m	2025/26 budget £m	2026/27 budget £m	2027/28 budget £m
Total Capital Expenditure	4.24	7.04	12.21	15.05	9.58	5.78	3.60

2.3. **Governance (capital expenditure):** The PCC's assets and infrastructure need continual investment in order to ensure an efficient and modern working environment. The Capital Programme reflects the implementation of the Estates, IT and Fleet Strategies. The implementation of Operation Uplift and reviewing the requirements as part of the planning cycle has resulted in revisions to the planned Programme. There have been a number of issues such as supply chain delays, planning consent delays and increased costs due to higher inflation which have delayed and made implementing the capital programme challenging. A major element of the existing Programme was the Emergency Service Network (ESN) replacement programme - this has now been delayed beyond the date of the Capital Programme. The profiling of each capital scheme is based on best estimates at a point in time, and these are constantly monitored and subject to review. However, in order to establish a base-level of funding a few critical work streams require to be included in the Capital Programme prior to the finalisation of a full business case. Some of these may ultimately require an element of re-profiling if they straddle two financial years e.g Body Worn Video (BWV) replacement.

2.4. All capital expenditure must be financed, either from external sources (government grants and other contributions), the Police and Crime Commissioner's own resources (revenue, reserves and capital receipts) or debt (borrowing, leasing and Private Finance Initiative). The planned financing of the above expenditure is as follows:

Table 2: Capital financing in £ millions

	2021/22 actual £m	2022/23 forecast £m	2023/24 budget £m	2024/25 budget £m	2025/26 budget £m	2026/27 budget £m	2027/28 budget £m
External sources	0.12	0.00	0.00	0.00	0.00	0.00	0.00
Capital receipts	0.06	0.43	0.25	2.52	0.75	0.10	0.00
Revenue resources	3.29	3.78	5.62	4.35	3.02	2.73	2.28
Debt	0.77	2.83	6.34	8.18	5.81	2.95	1.32
TOTAL	**4.24**	**7.04**	**12.21**	**15.05**	**9.58**	**5.78**	**3.60**

2.5. Debt is only a temporary source of finance, since loans and leases must be repaid, and this is therefore replaced over time by other financing, usually from revenue which is known as minimum revenue provision (MRP). Alternatively, proceeds from selling capital assets (known as capital receipts) may be used to replace debt finance. Planned MRP are as follows:

Table 3: Replacement of prior years' debt finance in £ millions

	2021/22 actual £m	2022/23 forecast £m	2023/24 budget £m	2024/25 budget £m	2025/26 budget £m	2026/27 budget £m	2027/28 budget £m
Budgeted MRP (Own resources)	2.74	2.39	2.52	2.82	3.22	3.62	4.21

- The Police and Crime Commissioner's full minimum revenue provision (MRP) statement is shown on Appendix B to this report

2.6. The Police and Crime Commissioner's cumulative outstanding amount of debt finance is measured by the capital financing requirement (CFR). This increases with new debt-financed capital expenditure and reduces with MRP and capital receipts used to replace debt. The CFR is expected to increase by £3.9m during 2023/24. Based on the above figures for expenditure and financing, the Police and Crime Commissioner's estimated CFR is as follows:

Table 4: Prudential Indicator: Estimates of Capital Financing Requirement in £ millions

	2021/22 actual £m	2022/23 forecast £m	2023/24 budget £m	2024/25 budget £m	2025/26 budget £m	2026/27 budget £m	2027/28 budget £m
Total CFR	28.00	28.44	32.35	37.88	40.46	39.79	37.11

2.7. **Asset management:** To ensure that capital assets continue to be of long-term use, the Police and Crime Commissioner has relevant Estates, Fleet and IT management strategies in place.

2.8. **Asset disposals:** When a capital asset is no longer needed, it may be sold so that the proceeds, known as capital receipts, can be spent on new assets or to repay debt. Repayments of capital grants, loans and investments also generate capital receipts. The Police and Crime Commissioner plans to receive £2.61m of capital receipts in the financial years 2022/23 onwards as follows:

Table 5: Capital receipts receivable in £ millions

	2021/22 actual £m	2022/23 forecast £m	2023/24 budget £m	2024/25 budget £m	2025/26 budget £m	2026/27 budget £m	2027/28 budget £m
Opening balance	**2.08**	**2.35**	**3.65**	**3.40**	**0.88**	**0.50**	**0.90**
Receipts	0.33	1.73	0.00	0.00	0.38	0.50	0.00
Budgeted use	(0.06)	(0.43)	(0.25)	(2.52)	(0.10)	(0.10)	(0.00)
Balance	**2.35**	**3.65**	**3.40**	**0.88**	**0.50**	**0.90**	**0.90**

3. <u>**Treasury Management**</u>

3.1. Treasury management is concerned with keeping sufficient but not excessive cash available to meet the Police and Crime Commissioner's spending needs, while managing the risks involved. Surplus cash is invested until required, while a shortage of cash will be met by borrowing, to avoid excessive credit balances or overdrafts in the bank current account. The Police and Crime Commissioner is typically cash rich in the short-term as revenue income is received before it is spent, but cash poor in the long-term as capital expenditure is incurred before being financed. The revenue cash surpluses are offset against capital cash shortfalls to reduce overall borrowing.

3.2. The Treasury Management Strategy (Appendix C) sets out the parameters under which the Treasury Management activities are governed and monitored. These are based on prioritising security first, liquidity second and yield last.

This does reduce potential investment income but minimises the risk of losing money through riskier investments. The below summarises the main points of the Treasury Management Strategy.

3.3. **Borrowing strategy:** The Police and Crime Commissioner's main objectives when borrowing are to achieve a low but certain cost of finance while retaining flexibility should plans change in future. These objectives are often conflicting, and the Police and Crime Commissioner therefore seeks to strike a balance between cheaper short-term loans and long-term fixed rate loans where the future cost is known but higher.

3.4. The Borrowing Strategy is also balanced by revenue cash available being used rather than borrowing, known as internal borrowing. Internal borrowing has been used extensively over recent years generating savings in interest charges per year and reducing risk by not investing cash. However, use of reserves to fund Capital has reduced the available amounts to internally borrow. Another factor to consider is that the Police and Crime Commissioner's income is not constant during the year; this is due to a Pension Grant of around £20m being received in one lump sum each July. Furthermore, for 2023/24 the Home Office Welsh Top-Up Grant of £22.5m will be paid in one lump sum upfront in April 2023 (as opposed to monthly instalments).

3.5. The Police and Crime Commissioner does not borrow to invest for the primary purpose of financial return and therefore retains full access to the Public Works Loans Board.

3.6. Projected levels of the Police and Crime Commissioner's total outstanding debt (which comprises borrowing, PFI liabilities, leases and transferred debt) are shown below, compared with the capital financing requirement (see above).

Table 6: Prudential Indicator: Gross Debt and the Capital Financing Requirement in £ millions

	2021/22 actual £m	**2022/23 forecast £m**	**2023/24 budget £m**	**2024/25 budget £m**	**2025/26 budget £m**	**2026/27 budget £m**	**2027/28 budget £m**
Debt (incl. PFI & leases)	17.10	15.65	14.12	12.50	10.79	8.97	7.04
Capital Financing Requirement	28.00	28.44	32.35	37.88	40.46	39.79	37.11

3.6. Statutory guidance is that debt should remain below the capital financing requirement, except in the short-term. As can be seen from table 6, the Police and Crime Commissioner expects to comply with this in the medium term.

3.7. **Liability benchmark:** To compare the Police and Crime Commissioner's actual borrowing against an alternative strategy, a liability benchmark has been calculated showing the lowest risk level of borrowing. This assumes that cash and investment balances are kept to a minimum level of £10m at each year-end.

Table 7: Borrowing and the Liability Benchmark in £ millions

	31.3.2022 actual £m	**31.3.2023 forecast £m**	**31.3.2024 budget £m**	**31.3.2025 budget £m**	**31.3.2026 budget £m**	**31.3.2027 budget £m**	**31.3.2028 budget £m**
Outstanding borrowing	8.88	8.38	7.88	7.38	6.88	6.38	5.88
Liability benchmark	(11.23)	(16.64)	(2.30)	9.83	15.95	17.52	17.20

The outstanding borrowing in the table above shows the current level of committed borrowing, and the liability benchmark is an indicator of the maximum we may need to borrow in order to keep cash and investment balances above £10m. The actual level of borrowing will depend on cashflow throughout the year and will be somewhere between the two levels outlined above.

3.8. **Affordable borrowing limit:** The Police and Crime Commissioner is legally obliged to set an affordable borrowing limit (also termed the authorised limit for external debt) each year and to keep it under review. In line with statutory guidance, a lower "operational boundary" is also set as a warning level should debt approach the limit.

Table 8: Prudential Indicators: Authorised limit and operational boundary for external debt in £m

	2022/23 limit £m	**2023/24 limit £m**	**2024/25 limit £m**	**2025/26 limit £m**	**2026/27 limit £m**	**2027/28 limit £m**
Authorised limit – borrowing	24.61	27.10	33.75	37.55	38.20	36.94
Authorised limit – PFI and leases	7.28	6.24	5.13	3.91	2.60	1.17
Authorised limit – total external debt	**31.89**	**33.34**	**38.88**	**41.46**	**40.80**	**38.11**
Operational boundary – borrowing	22.61	25.10	31.75	35.55	36.20	34.94
Operational boundary – PFI and leases	7.28	6.24	5.13	3.91	2.60	1.17
Operational boundary – total external debt	**29.89**	**31.34**	**36.88**	**39.46**	**38.80**	**36.11**

3.9. **Treasury investment strategy:** Treasury investments arise from receiving cash before it is paid out again. Investments made for service reasons or for pure financial gain are not generally considered to be part of treasury management.

3.10. The Police and Crime Commissioner's policy on treasury investments is to prioritise security and liquidity over yield, that is to focus on minimising risk rather than maximising returns. Cash that is likely to be spent in the near term is invested securely, for example with the government, other local authorities or selected high-quality banks, to minimise the risk of loss. Money that will be held for longer terms is invested more widely, including in bonds, shares and property, to balance the risk of loss against the risk of receiving returns below inflation. Both near-term and longer-term investments may be held in pooled funds, where an external fund manager makes decisions on which particular investments to buy and the Police and Crime Commissioner may request its money back at short notice.

Table 9: Treasury management investments in £millions

	31.3.2022 actual £m	**31.3.2023 forecast £m**	**31.3.2024 budget £m**	**31.3.2025 budget £m**	**31.3.2026 budget £m**	**31.3.2027 budget £m**	**31.3.2028 budget £m**
Near-term investments	30.1	35.02	17.75	10.00	10.00	10.00	10.00
Longer-term investments	0.00	0.00	0.00	0.00	0.00	0.00	0.00
TOTAL	**30.1**	**35.02**	**17.75**	**10.00**	**10.00**	**10.00**	**10.00**

3.11. **Risk management:** The effective management and control of risk are prime objectives of the Police and Crime Commissioner's treasury management activities. The treasury management strategy therefore sets out various indicators and limits to constrain the risk of unexpected losses and details the extent to which financial derivatives may be used to manage treasury risks.

3.12. **Governance (risk management):** Decisions on treasury management investment and borrowing are made daily and are therefore delegated to the Head of Finance and staff, who must act in line with the treasury management strategy approved by the Police and Crime Commissioner and Joint Audit Committee (JAC). Reports on treasury management activity are presented to The Strategic Executive Board (SEB) and JAC. The JAC is responsible for scrutinising treasury management decisions.

3.13. **Investments for Service Purposes:** The Police and Crime Commissioner **does not** currently make investments to assist local public services (which might include making loans to or buying shares in local service providers and/or local small businesses to promote economic growth).

3.14. **Commercial Activities:** Despite central government financial support for local public services declining, the Police and Crime Commissioner **does not** invest in commercial property purely or mainly for financial gain.

3.15. **Liabilities:** In addition to debt detailed above, the Police and Crime Commissioner is committed to making future payments to cover its pension fund costs. Police Officers' pension scheme is an unfunded scheme which is underwritten by the Government, and the liabilities stood at £1,888.0m as at 31.3.22. The cost to the Police and Crime Commissioner is the employer contribution rate, which is currently 31%. The deficit on the Staff Pension fund stood at £62.0m as at 31.3.22, this is also managed through the contribution rate which is currently set at 19% (and will be reducing to 18.7% from April 2023).

3.16. **Governance (liabilities):** Decisions on incurring new discretional liabilities are taken by the Chief Officer Team in consultation with the Police and Crime Commissioner and his Chief Finance Officer. The risk of liabilities crystallising and requiring payment is monitored by Corporate Finance and reported to the Strategic Management Board (SMB) and SEB as necessary. Details of contingent liabilities as at 31 March will be included in the annual Statement of Accounts.

4. Revenue Budget Implications

4.1. Although capital expenditure is not charged directly to the revenue budget, interest payable on loans and MRP are charged to revenue. The net annual charge is known as financing costs; this is compared to the net revenue stream i.e. the amount funded from Council Tax, business rates and general government grants.

Table 10: Prudential Indicator: Proportion of financing costs to net revenue stream

	2021/22 actual	**2022/23 forecast**	**2023/24 budget**	**2024/25 budget**	**2025/26 budget**	**2026/27 budget**	**2027/28 budget**
Financing costs (£m)	£3.68m	£3.25m	£3.20m	£3.31m	£3.78m	£4.06m	£4.32m
Financing costs as % of net revenue stream	**2.1%**	**1.8%**	**1.7%**	**1.7%**	**1.9%**	**2.0%**	**2.1%**
Level of debt (£m)	£17.10m	£15.65m	£14.12m	£12.50m	£10.79m	£8.97m	£7.04m
Level of debt as % of net revenue stream	9.9%	8.6%	7.5%	6.4%	5.4%	4.4%	3.4%
Level of CFR as % of net revenue stream	16.2%	16.9%	21.9%	22.2%	20.2%	19.8%	19.5%

4.2. **Sustainability:** Due to the very long-term nature of capital expenditure and financing, the revenue budget implications of expenditure incurred in the next few years will extend for up to 50 years into the future. The Police and Crime Commissioner’s Finance Officer and the Director of Finance and Resources are satisfied that the proposed capital programme is prudent, affordable and sustainable as there are revenue streams or reserves in place to fund the Programme as set out. It is likely that additional resources will need to be budgeted for future investments beyond the current Programme.

5. Knowledge and Skills

5.1. The Police and Crime Commissioner employs professionally qualified and experienced staff in senior positions with responsibility for making capital expenditure, borrowing and investment decisions. Training is provided to all staff involved in making capital expenditure, borrowing and investment decisions.

5.2. Where Police and Crime Commissioner staff do not have the knowledge and skills required, use is made of external advisers and consultants that are specialists in their field. The Police and Crime Commissioner currently employs Arlingclose Limited as treasury management advisers, Wilks Head and Eve as property consultants and BDO as tax consultants. This approach is more cost effective than employing such staff directly and ensures that the Police and Crime Commissioner has access to knowledge and skills commensurate with its risk appetite.

APPENDIX A

2021-22		2022-23	2023-24	2024-25	2025-26	2026-27	2027-28	
								Total
Actuals	Description	Revised	Est	Est	Est	Est	Est	Project
		Estimate						Costs
								2022-23 to
								2027-28
£000		£000	£000	£000	£000	£000	£000	£000
	Estate Programme							
26	Retentions, Consultancy and QS	**25**						**25**
	Sustainability Improvements	**152**	250	100	100	100		**702**
	Estates estimate 25-26 onwards				2,000			**2,000**
241	Pwllheli PS							**0**
	Holyhead PS	**250**	2,927	3,323				**6,500**
	Force HQ Canteen							**0**
141	Caernarfon & North Gwynedd Estate Area	**250**	376					**626**
323	VCC / Vehicle Workshop	**1,577**						**1,577**
	Armed Alliance							**0**
	Dolgellau PS				1,200			**1,200**
	Abergele PS		391					**391**
	Llanrwst PS	**150**	28					**178**
	Flintshire PS - North			700	2,300			**3,000**
	Flintshire PS - South		50	3,650	450			**4,150**
	Force Control Room Upgrading	**150**						**150**
	Archive Store			750				**750**
	Rhosllanerchrugog PS			190				**190**
56	Re locate/ co locate/ vacate	**130**	164					**294**
346	Firearms Base works	**38**				2,000		**2,038**
	CS - SARC ISO Accreditation	**25**	575					**600**
1,133	**Total Building Works**	**2,747**	**4,761**	**8,713**	**6,050**	**2,100**	**0**	**24,371**
	Vehicles and Other Equipment							
650	Vehicle Purchase Replacement Programme	**1,485**	2,856	1,620	1,756	1,300	1,642	**10,659**
	PSU Vehicles (replacemnt programme)			780				**780**
	Electric Vehicles		41	41	41	41	41	**205**
	Tranman development	**0**	60					**60**
	Intoxilators x 3	**30**						**30**
105	ANPR replacement	**150**						**150**
134	Collision Surveying Equipment	**41**						**41**
889	**Total Vehicles and Other Equipment**	**1,706**	**2,957**	**2,441**	**1,797**	**1,341**	**1,683**	**11,925**

2021-22 Actuals	Description	2022-23 Revised Estimate	2023-24 Est	2024-25 Est	2025-26 Est	2026-27 Est	2027-28 Est	Total Project Costs 2022-23 to 2027-28
£000		£000	£000	£000	£000	£000	£000	£000
	Information Technology and Communication Equipment							
525	Desk Top Replacement (Replacement Programme)	**500**	682	1,800	1,736	1,054	820	**6,592**
	Server Replacement	**280**	420			700		**1,400**
19	Lockers for charging and storage							**0**
	Business Systems Servers (Replacement Programme)							**0**
	DFU Server replacement		270					**270**
	Telephony		250					**250**
12	Nexus Upgrade	**368**						**368**
	Digital Interview Recorder		450					**450**
63	NEP Device Re-build	**255**						**255**
133	Mobile data devices	**468**				585		**1,053**
	NEP Infrastructure/Sail Point/Internet Links	**22**						**22**
40	Digital Workplace audio visual	**0**	86					**86**
	Digital Intelligence & Investigation	**0**	196					**196**
1,198	Command and Control Upgrade - Phase 2	**600**	755					**1,355**
	Life-X Deployment	**0**		**1,100**				**1,100**
72	Emergency Service Network	**0**						**0**
	Airwave replacement units	**90**	285	1,000				**1,375**
	Body Worn Video (replacement costs)		1,100			**0**	1,100	**2,200**
	Mobile app							**0**
93	Wi-Fi							**0**
63	National Enablement Programme							**0**
2,218	**Total Information Technology and Communication**	**2,583**	**4,494**	**3,900**	**1,736**	**2,339**	**1,920**	**16,972**
4,240	**Total Capital Expenditure**	**7,036**	**12,212**	**15,054**	**9,583**	**5,780**	**3,603**	**53,268**

2021-22 Actuals	Description	2022-23 Revised Estimate	2023-24 Est	2024-25 Est	2025-26 Est	2026-27 Est	2027-28 Est
£000		£000	£000	£000	£000	£000	£000
1,133	Total Building Works	2,747	4,761	8,713	6,050	2,100	0
889	Total Vehicles and Other Equipment	1,706	2,957	2,441	1,797	1,341	1,683
2,218	Total Information Technology and Communication	2,583	4,494	3,900	1,736	2,339	1,920
4,240	**Total Capital Expenditure**	**7,036**	**12,212**	**15,054**	**9,583**	**5,780**	**3,603**
	Funding						
123	Home Office Grant	0	0	0	0	0	0
2,465	Revenue Contribution	2,946	3,327	3,082	3,025	2,726	2,280
820	Earmarked Reserves	835	2,297	1,270	0	0	0
61	Capital Receipts	426	250	2,523	750	100	0
638	Borrowing for Estates	2,271	4,386	5,790	4,620	2,000	0
133	Borrowing for replacement programme	558	1,952	2,389	1,188	954	1,323
4,240	**Total Funding**	**7,036**	**12,212**	**15,054**	**9,583**	**5,780**	**3,603**

APPENDIX B

Annual Minimum Revenue Provision Statement 2023/24

Where the Police and Crime Commissioner 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 Police and Crime Commissioner to have regard to Welsh Government's *Guidance on Minimum Revenue Provision* (the WG Guidance) most recently issued in 2018.

The broad aim of the WG 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, or, in the case of borrowing supported by Government Revenue Support Grant, reasonably commensurate with the period implicit in the determination of that grant.

The WG Guidance requires the Police and Crime Commissioner to approve an Annual MRP Statement each year and recommends a number of options for calculating a prudent amount of MRP. The following statement only incorporates options recommended in the Guidance.

- For capital expenditure incurred before 1st April 2008 MRP will be determined as 4% of the capital financing requirement in respect of that expenditure. *(Option 2)*

- For capital expenditure incurred after 31st March 2008, MRP will be determined by charging the expenditure over the expected useful life of the relevant asset in equal instalments, starting in the year after the asset becomes operational. MRP on purchases of freehold land will be charged over 50 years. MRP on expenditure not related to fixed assets but which has been capitalised by regulation or direction will be charged over 20 years. *(Option 3)*

- For assets acquired by 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.

- Where former operating leases have been brought onto the balance sheet due to the adoption of the *IFRS 16 Leases* accounting standard, and the asset values have been adjusted for accruals, prepayments, premiums and/or incentives, then the annual MRP charges will be adjusted so that the total charge to revenue remains unaffected by the new standard.

Capital expenditure incurred during 2023/24 will not be subject to a MRP charge until 2024/25 or later.

Based on the Police and Crime Commissioner's latest estimate of its capital financing requirement (CFR) on 31st March 2023, the budget for MRP has been set as follows:

	31.03.2023 Estimated CFR £m	**2023/24 Budgeted MRP £**
Capital expenditure before 01.04.2008	6.95	0.28
Capital expenditure after 31.03.2008	14.26	1.21
Leases and Private Finance Initiative	7.23	1.03
Total General Fund	**28.44**	**2.52**

APPENDIX C

Treasury Management Strategy Statement 2023/24

1. Introduction

1.1. Treasury management is the management of the Police and Crime Commissioner's cash flows, borrowing and investments, and the associated risks. The Police and Crime Commissioner has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of financial risk are therefore central to the Police and Crime Commissioner's prudent financial management.

1.2. Treasury risk management at the Police and Crime Commissioner is conducted within the framework of 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 Police and Crime Commissioner to approve a treasury management strategy before the start of each financial year. In addition, the Welsh Government (WG) issued revised Guidance on Local Police and Crime Commissioner Investments in November 2019 that requires the Police and Crime Commissioner to approve an investment strategy before the start of each financial year. This report fulfils the Police and Crime Commissioner's legal obligation under the *Local Government Act 2003* to have regard to both the CIPFA Code and the WG Guidance.

1.3. **Revised strategy:** In accordance with the WG Guidance, the Police and Crime Commissioner 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 Police and Crime Commissioner's capital programme or in the level of its investment balance, or a material loss in the fair value of a non-financial investment identified as part of the year end accounts preparation and audit process.

2. External Context *(below relates to data/commentary as at 06/01/23. Further weekly 'Review and Preview' emails have also been received from Arlingclose, as well as relevant daily updates).*

2.1. **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 Police and Crime Commissioner's treasury management strategy for 2023/24.

2.2. 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%.

2.3. 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.

2.4. 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.

2.5. 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.

2.6. 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.

2.7. 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.

2.8. 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%.

2.9. **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.

2.10. 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.

2.11. 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.

2.12. 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.

2.13. 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.

2.14. **Interest rate forecast (December 2022):** The Police and Crime Commissioner'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.

2.15. 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.

2.16. 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.

2.17. A more detailed economic and interest rate forecast provided by Arlingclose is attached at Appendix C.1.

3. **Local Context**

3.1. On 31st March 2023, the Police and Crime Commissioner is expected to hold £8.38m of borrowing and £35.02m of treasury investments. Forecast changes in these sums are shown in the balance sheet analysis in table 1 below.

Table 1: Balance sheet summary and forecast

	31.3.22 Actual £m	31.3.23 Estimate £m	31.3.24 Forecast £m	31.3.25 Forecast £m	31.3.26 Forecast £m	31.3.27 Forecast £m	31.3.28 Forecast £m
Capital financing requirement	28.00	28.44	32.35	37.88	40.46	39.79	37.11
Less: Other debt liabilities *	(8.23)	(7.28)	(6.24)	(5.13)	(3.91)	(2.60)	(1.17)
Loans CFR	**19.77**	**21.16**	**26.11**	**32.75**	**36.55**	**37.19**	**35.94**
Less: External borrowing **	(8.88)	(8.38)	(7.88)	(7.38)	(6.88)	(6.38)	(5.88)
Internal (over) borrowing	**10.89**	**12.78**	**18.23**	**25.37**	**29.67**	**30.81**	**30.06**
Less: Balance sheet resources	(41.00)	(47.81)	(38.40)	(32.92)	(30.60)	(29.67)	(28.75)
(Treasury investments) or New borrowing	**(30.11)**	**(35.03)**	**(20.17)**	**(7.55)**	**(0.93)**	**1.14**	**1.31**

* leases and PFI liabilities that form part of the Police and Crime Commissioner's total debt

** shows only loans to which the Police and Crime Commissioner is committed and excludes optional refinancing

3.2. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while balance sheet resources are the underlying sums available for investment. The Police and Crime Commissioner's current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing.

3.3. The Police and Crime Commissioner has an increasing CFR due to the capital programme but decreasing investments may lead to a need to borrow up to £7.2m (which includes £5.88m of existing borrowing) over the forecast period in order to maintain a positive level of liquidity/breakeven (see also 3.5 below). However, if the capital programme is delayed this will also impact on the timing of our need to borrow.

3.4. CIPFA's *Prudential Code for Capital Finance in Local Authorities* recommends that the Police and Crime Commissioner's total debt should be lower than its highest forecast CFR over the next three years. Table 1 shows that the Police and Crime Commissioner expects to comply with this recommendation during 2023/24.

3.5. **Liability benchmark:** To compare the Police and Crime Commissioner's actual borrowing against an alternative strategy, a liability benchmark has been calculated showing the lowest risk level of borrowing. This assumes the same forecasts as table 1 above, but that cash and investment balances are kept to a minimum level of £10m at each year-end to maintain sufficient liquidity but minimise credit risk.

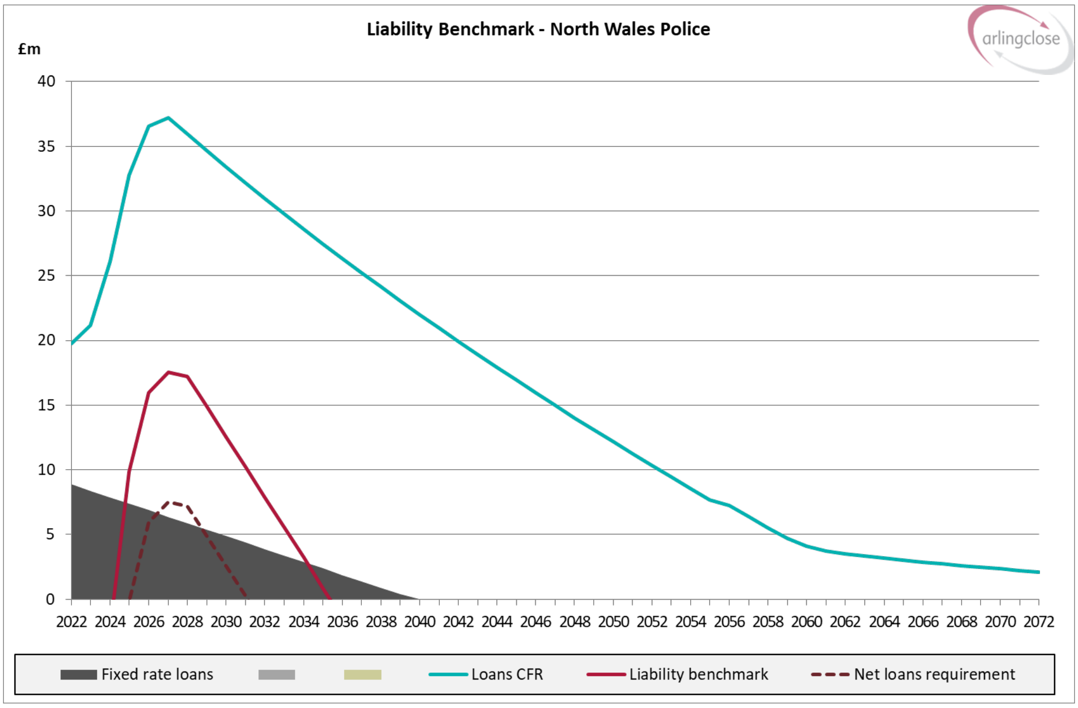
3.6. The liability benchmark is an important tool to help establish whether the Police and Crime Commissioner is likely to be a long-term borrower or long-term investor in the future, and so shape its strategic focus and decision making. The liability benchmark itself represents an estimate of the cumulative amount of external borrowing the Police and Crime Commissioner 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.

Table 2: Prudential Indicator: Liability benchmark

	31.3.22 Actual £m	31.3.23 Estimate £m	31.3.24 Forecast £m	31.3.25 Forecast £m	31.3.26 Forecast £m	31.3.27 Forecast £m	31.3.28 Forecast £m
Loans CFR	19.77	21.17	26.10	32.75	36.55	37.20	35.94
Less: Balance sheet resources	(41.00)	(47.81)	(38.40)	(32.92)	(30.60)	(29.67)	(28.75)
Net loans requirement	**(21.23)**	**(26.64)**	**(12.30)**	**(0.17)**	**5.95**	**7.53**	**7.19**
Plus: Liquidity allowance	10.00	10.00	10.00	10.00	10.00	10.00	10.00
Liability benchmark	**(11.23)**	**(16.64)**	**(2.30)**	**9.83**	**15.95**	**17.53**	**17.19**

3.7. Following on from the medium-term forecasts in table 2 above, the Police and Crime Commissioner plans to remain borrowed in line with its cash-flow forecast in order to minimise risk. The cash-flow forecast reflects the peaks and troughs over the financial year whereas the liability benchmark reflects a specific point in time – both need to be considered when deciding to borrow:

Graph 1: Liability Benchmark



4. Borrowing Strategy

4.1. The Police and Crime Commissioner currently holds £8.38 million of loans, a decrease of £0.50 million on the previous year, as part of its strategy for funding previous years' capital programmes. The balance sheet forecast in table 1 shows that the Police and Crime Commissioner does not expect to need to borrow in 2023/24. The Police and Crime Commissioner may however borrow to pre-fund future years' requirements, providing this does not exceed the authorised limit for borrowing of £33.34 million.

4.2. **Objectives:** The Police and Crime Commissioner's 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 Police and Crime Commissioner's long-term plans change is a secondary objective.

4.3. **Strategy:** Given the significant cuts to public expenditure and in particular to local government funding, the Police and Crime Commissioner'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.

4.4. By doing so, the Police and Crime Commissioner is able to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk. The benefits of internal and 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 Police and Crime Commissioner with this 'cost of carry' and breakeven analysis. Its output may determine whether the Police and Crime Commissioner 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.

4.5. The Police and Crime Commissioner has previously raised all of its long-term borrowing from the PWLB but will consider long-term loans from other sources including banks, pensions and local authorities, in order to lower interest costs and reduce over-reliance on one source of funding in line with the CIPFA Code. PWLB loans are no longer available to local authorities planning to buy investment assets primarily for yield; however the Police and Crime Commissioner intends to avoid this activity and so will retain its access to PWLB loans.

4.6. Alternatively, the Police and Crime Commissioner 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.

4.7. In addition, the Police and Crime Commissioner may borrow short-term loans to cover unplanned cash flow shortages.

4.8. **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 (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 Gwynedd Pension Fund)
- capital market bond investors
- UK Municipal Bonds Agency plc and other special purpose companies created to enable local Police and Crime Commissioner bond issues

4.9. **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:

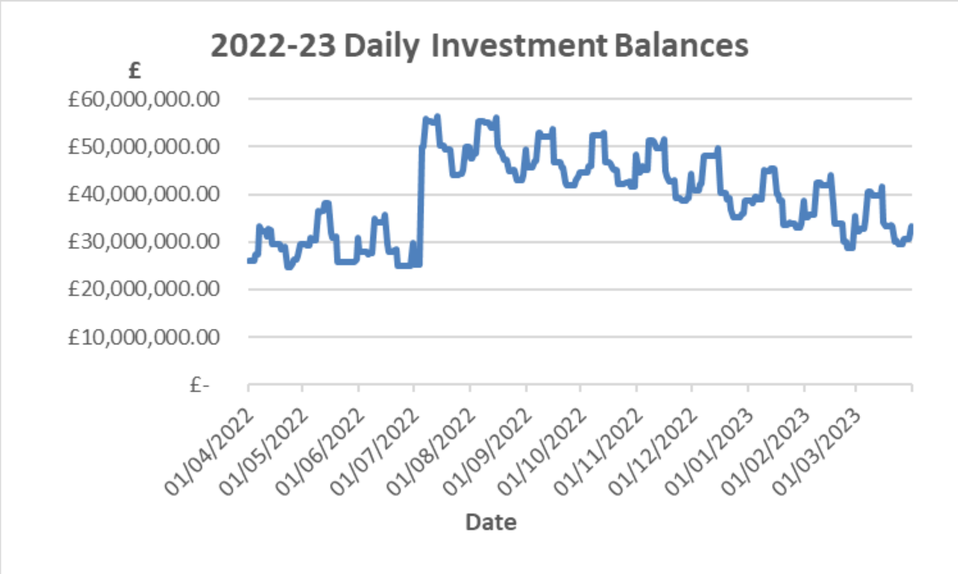
- leasing
- hire purchase
- Private Finance Initiative
- sale and leaseback

4.10. **Short-term and variable rate loans**: These loans leave the Police and Crime Commissioner 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. However normal practice is to borrow and/or invest at fixed rates which removes any interest rate exposure risk.

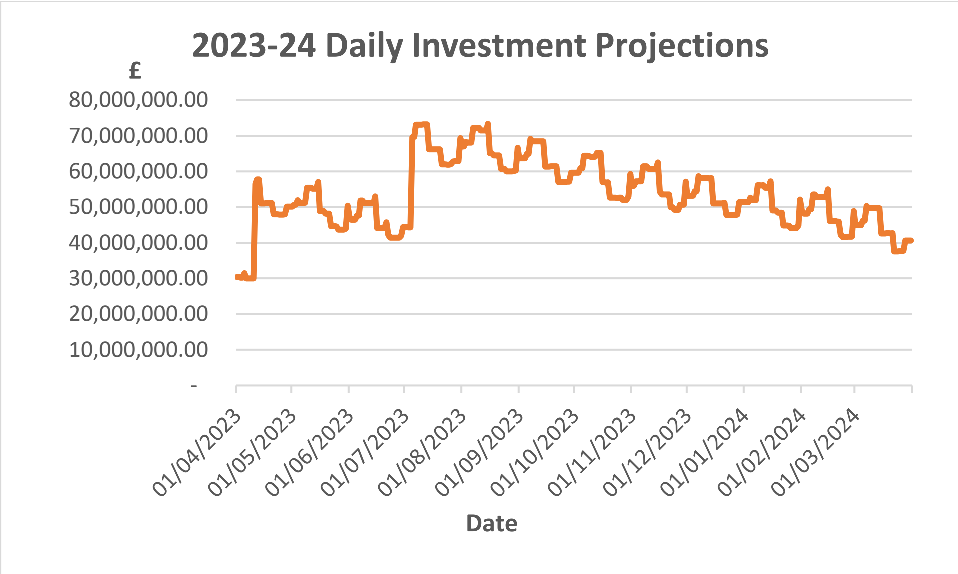
5. <u>Treasury Investment Strategy</u>

5.1. The Police and Crime Commissioner holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. In the past 12 months, the Police and Crime Commissioner's treasury investment balance has ranged between £56.4 and £24.8 million (Graph 2). Projections for the forthcoming year show a similar trend with the exception of the Home Office Welsh Top-Up Grant of £22.5m being paid in one lump sum upfront in April 2023 (as opposed to monthly instalments) (Graph 3).

Graph 2: Daily investment balance (2022-23)



Graph 3: Daily investment projection (2023-24)



5.2. **Objectives:** Both the CIPFA Code and the WG Guidance require the Police and Crime Commissioner 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 Police and Crime Commissioner's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income. Where balances are expected to be invested for more than one year, the Police and Crime Commissioner 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. The Police and Crime Commissioner aims to be a responsible investor and will consider environmental, social and governance (ESG) issues when investing.

5.3. **Strategy:** As demonstrated by the liability benchmark above, the Police and Crime Commissioner expects to be a long-term borrower and treasury investments will therefore be made primarily to manage day-to-day cash flows using short-term low risk instruments.

5.4. **ESG policy:** 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 Police and Crime Commissioner's ESG policy does not currently include ESG scoring or other real-time ESG criteria at an individual investment level. When investing in banks and funds, the Police and Crime Commissioner will prioritise banks that are signatories to the UN Principles for Responsible Banking and funds operated by managers that are signatories to the UN Principles for Responsible Investment, the Net Zero Asset Managers Alliance and/or the UK Stewardship Code. Arlingclose intend to publish on a quarterly basis which counterparties and fund managers are signatories to ESG-related initiatives.

5.5. **Business models:** Under the IFRS 9 standard, the accounting for certain investments depends on the Police and Crime Commissioner's "business model" for managing them. The Police and Crime Commissioner aims to achieve value from its treasury investments by a business model of collecting the contractual cash flows and therefore, where other criteria are also met, these investments will continue to be accounted for at amortised cost.

5.6. **Approved counterparties:** The Police and Crime Commissioner may invest its surplus funds with any of the counterparty types in table 3 below, subject to the limits shown.

Table 3: Treasury investment counterparties and limits

Sector	Counterparty limit (Proposed)	Counterparty limit (Current)	Sector limit
The UK Government	Unlimited	Unlimited	n/a
Local authorities & other government entities	£7.5m	£7m	Unlimited
HSBC[1*]	£10m	£10m	n/a
Secured investments *	£7.5m	£7m	Unlimited
Banks (unsecured) *	£5m	£4m	Unlimited
Building societies (unsecured) *	£4m	£4m	Unlimited
Registered providers (unsecured) *	£5m	£4m	£5m
Money market funds *	£5m	£4m	Unlimited
Strategic pooled funds*	£5m	£4m	£5m

1 These are the Commissioner's bankers and are currently rated AA- by Fitch credit rating agency
This table must be read in conjunction with the notes below.

5.7. ***Minimum credit rating:** Treasury investments in the sectors marked with an asterisk 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 where external advice indicates the entity to be of similar credit quality.

5.8. **Government:** Loans to, and 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.

5.9. **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.

5.10. **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.

5.11. **Registered providers (unsecured):** Loans to, and bonds issued or guaranteed by, registered providers of social housing or 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 for Communities (in Northern Ireland). As providers of public services, they retain the likelihood of receiving government support if needed.

5.12. **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 Police and Crime Commissioner will take care to diversify its liquid investments over a variety of providers to ensure access to cash at all times.

5.13. **Strategic pooled funds:** Bond, equity and property funds that offer enhanced returns over the longer term but are more volatile in the short term. These allow the Police and Crime Commissioner to diversify into asset classes other than cash without the need to own and manage the underlying investments. Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Police and Crime Commissioner's investment objectives will be monitored regularly.

5.14. **Operational bank accounts:** The Police and Crime Commissioner may incur operational exposures, for example through 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 £10 million 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 Police and Crime Commissioner maintaining operational continuity.

5.15. **Risk assessment and credit ratings**: Credit ratings are obtained and monitored by the Police and Crime Commissioner'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.

5.16. 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.

5.17. **Other information on the security of investments**: The Police and Crime Commissioner 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, reports in the quality financial press and analysis and advice from the Police and Crime Commissioner'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 above criteria.

5.18. 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 Police and Crime Commissioner 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 Police and Crime Commissioner'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.

5.19. **Investment limits**: The Police and Crime Commissioner's revenue reserves available to cover investment losses are forecast to be £48 million on 31st March 2023 and £36 million on 31st March 2024. In order that these reserves are not put at risk in the case of a single default, the maximum that will be lent to any one organisation (other than the UK Government) will be as shown in table 3 above. It is proposed to slightly increase these limits from 2023/24 onwards to reflect the increase in cashflow projection as outlined in Graph 3. A group of entities under the same ownership will be treated as a single organisation for limit purposes.

5.20. **Liquidity management**: The Police and Crime Commissioner uses purpose-built cash flow forecasting methods 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 Police and Crime Commissioner being forced to borrow on unfavourable terms to meet its financial commitments. Limits on long-term investments are set by reference to the Police and Crime Commissioner's medium-term financial plan and cash flow forecast. The Police and Crime Commissioner will spread its liquid cash over approved providers (e.g. bank accounts and money market funds) to ensure that access to cash is maintained in the event of operational difficulties at any one provider.

6. Treasury Management Prudential Indicators

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

6.2. **Security:** The Police and Crime Commissioner has adopted a voluntary measure of its exposure to credit risk by setting a minimum credit rating of A- for its investments.

Credit risk indicator	**Target**
Minimum credit rating for investments	A-

6.3. **Liquidity:** The Police and Crime Commissioner has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments within a rolling twelve-month period, without additional borrowing. For practical purposes a lower operational limit of £7.5 million for a maximum of 14 days will be set to avoid unnecessary short-term borrowing.

Liquidity risk indicator	**Limit**
Minimum cash available within 12 months	£10m
Lower limit for a maximum of 14 days	£7.5m

6.4. **Interest rate exposures**: This indicator is set to control the Police and Crime Commissioner'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 one-year revenue impact of a 1% rise in interest rates	£50,000
Upper limit on one-year revenue impact of a 1% fall in interest rates	£50,000

The impact of a change in interest rates is calculated on the assumption that maturing loans and investments will be replaced at new market rates. However normal practice is to borrow and/or invest at fixed rates which removes any interest rate exposure risk.

6.5. **Maturity structure of borrowing:** This indicator is set to control the Police and Crime Commissioner's exposure to refinancing risk. The upper and lower limits on the maturity structure of borrowing will be:

Refinancing rate risk indicator	Upper limit	Lower limit
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.

6.6. **Long-term treasury management investments:** The purpose of this indicator is to control the Police and Crime Commissioner's exposure to the risk of incurring losses by seeking early repayment of its investments. The prudential limits on the long-term treasury management investments will be:

Price risk indicator	2023/24	2024/25	2025/26
Limit on principal invested beyond year end	£5m	£3m	£1m

7. **Related Matters**

7.1. The CIPFA Code requires the Police and Crime Commissioner to include the following in its treasury management strategy.

7.2. **Financial derivatives:** In the absence of any explicit legal power to do so, the Police and Crime Commissioner 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.

7.3. **Markets in Financial Instruments Directive**: The Police and Crime Commissioner has opted up to professional client status with its providers of financial services, including advisers, banks, brokers and fund managers, allowing it access to a greater range of services but without the greater regulatory protections afforded to individuals and small companies. Given the size and range of the Police and Crime Commissioner's treasury management activities, the Chief Finance Officer believes this to be the most appropriate status.

7.4. **Government Guidance:** Further matters required by the WG Guidance are included in Appendix C.2.

8. **Financial Implications**

8.1. The budget for investment income in 2023/24 is £1 million (£0.15 million permanent budget, and £0.85 million temporary budget increase due to higher projected interest rates). The budget for debt interest paid in 2023/24 is £0.10 million, based on committed fixed rate long term loans and an estimate to cover potential short-term borrowing. If actual levels of investments and borrowing, or actual interest rates, differ from those forecasts, performance against budget will be correspondingly different.

9. Other Options Considered

9.1. The CIPFA Code does not prescribe any particular treasury management strategy for local authorities to adopt. The Chief Finance Officer, having consulted the Joint Audit Committee, 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 listed 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

APPENDIX C.1

Arlingclose Economic & Interest Rate Forecast – December 2022

Underlying assumptions:

- 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.
- 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%

APPENDIX C.2

Additional requirements of Welsh Government Investment Guidance

The Welsh Government (WG) published revised Investment Guidance in November 2019 which places additional reporting requirements upon local authorities that are not integral to this Police and Crime Commissioner's treasury management processes. The guidance also covers investments that are not part of treasury management, for example investment property and loans to local organisations.

Contribution: The Police and Crime Commissioner's investments contribute to its service delivery objectives and supports effective treasury management activities.

Climate change: The Police and Crime Commissioner's investment decisions consider long-term climate risks to support a low carbon economy.

Specified investments: The WG Guidance defines specified investments as those:

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

The Police and Crime Commissioner 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.

Loans: The WG Guidance defines a loan as a written or oral agreement where the Police and Crime Commissioner temporarily transfers cash to a third party, joint venture, subsidiary or associate who agrees a return according to the terms and conditions of receiving the loan, except where the third party is another local Police and Crime Commissioner.

The Police and Crime Commissioner uses an allowed 'expected credit loss' model for loans and receivables as set out in *International Financial Reporting Standard 9 Financial Instruments* as adopted by proper practices to measure the credit risk of its loan portfolio. Appropriate consideration is given to state aid rules and competition law. The Police and Crime Commissioner has appropriate credit control arrangements to recover overdue repayments in place.

Non-specified investments: Any financial investment not meeting the definition of a specified investment or a loan is classed as non-specified. Given the wide definition of a loan, this category only applies to units in pooled funds and shares in companies. The Police and Crime Commissioner confirms that it doesn't currently have any non-specified investments

Non-financial investments: This category covers non-financial assets held primarily or partially to generate a profit, primarily investment property. Security is determined by comparing each asset's purchase price to its fair value using the model in International Accounting Standard 40: Investment Property as adapted by proper practices. The Police and Crime Commissioner does not hold any non-financial investments.

Investment advisers: The Police and Crime Commissioner has appointed Arlingclose Limited as treasury management advisers. The quality of these services is managed by regular strategy meetings, review of data provided and professional judgement.

Borrowing in advance of need: Welsh Government guidance is that local authorities must not borrow more than or in advance of their needs purely in order to profit from the investment of the extra sums borrowed.

Capacity and skills: The Police and Crime Commissioner employs professionally qualified and experienced staff in senior positions with responsibility for making capital expenditure, borrowing and investment decisions. Training is provided to all staff involved in making capital expenditure, borrowing and investment decisions.

Corporate governance: Decisions on treasury management investment and borrowing are made daily and are therefore delegated to the Head of Finance and staff, who must act in line with the treasury management strategy approved by the Police and Crime Commissioner and Joint Audit Committee (JAC). End of year and half yearly reports on treasury management activity are presented to SEB and JAC. The JAC is responsible for scrutinising treasury management decisions.