Capital Strategy Report 2024/25

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 8 February 2024 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

	2022/23 actual £m	2023/24 forecast £m	2024/25 budget £m	2025/26 budget £m	2026/27 budget £m	2027/28 budget £m	2028/29 budget £m
Total Capital Expenditure	6.89	6.64	18.12	9.32	7.57	5.88	10.21

2.3. **Governance (capital expenditure):** The Police and Crime Commissioner's assets and infrastructure need continual investment in order to ensure an efficient and modern working environment. The Capital Programme as a whole needs to be affordable, provide value for money, be deliverable, and reflect the overall strategy of having an infrastructure that is fit for the future. The Capital Programme reflects the implementation of the Estates, IT and Fleet Strategies. There have been a number of issues such as supply chain delays, planning consent delays and increased costs due to higher inflation which have slowed progress. 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

	2022/23 actual £m	2023/24 forecast £m	2024/25 budget £m	2025/26 budget £m	2026/27 budget £m	2027/28 budget £m	2028/29 budget £m
External sources	0.00	0.62	0.00	0.00	0.00	0.00	0.00
Capital receipts	0.42	0.20	2.70	0.00	0.65	0.00	0.00
Revenue resources	4.01	4.32	7.95	4.63	2.97	2.66	5.06
Debt	2.46	1.49	7.47	4.69	3.95	3.22	5.15
TOTAL	**6.89**	**6.64**	**18.12**	**9.32**	**7.57**	**5.88**	**10.21**

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

	2022/23 actual £m	2023/24 forecast £m	2024/25 budget £m	2025/26 budget £m	2026/27 budget £m	2027/28 budget £m	2028/29 budget £m
Budgeted MRP (Own resources)	2.42	2.45	2.23	2.99	3.36	3.62	3.56

- The Police and Crime Commissioner's full minimum revenue provision policy 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 £5.24m during 2024/25. 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

	2022/23 actual £m	2023/24 forecast £m	2024/25 budget £m	2025/26 budget £m	2026/27 budget £m	2027/28 budget £m	2028/29 budget £m
Total CFR	28.04	27.08	32.32	34.02	34.62	34.22	35.82

** a detailed review of leased assets will be undertaken in 2024/25 due to the change in the accounting for leases (IFRS 16) – this may result in an increase in the total CFR but will not impact the Loans CFR. Any material change will be reported in year.*

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 £0.32m of capital receipts in the coming financial year as follows:

Table 5: Capital receipts receivable in £ millions

	2022/23 actual £m	2023/24 forecast £m	2024/25 budget £m	2025/26 budget £m	2026/27 budget £m	2027/28 budget £m	2028/29 budget £m
Opening balance	**2.36**	**3.58**	**3.55**	**1.25**	**1.25**	**0.60**	**0.60**
Receipts	1.64	0.17	0.32	-	-	-	-
Budgeted use	(0.42)	(0.20)	(2.62)	0.00	(0.65)	0.00	0.00
Balance	**3.58**	**3.55**	**1.25**	**1.25**	**0.60**	**0.60**	**0.60**

3. Treasury Management

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. **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.

3.3. 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.

3.4. 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

	2022/23 actual £m	2023/24 forecast £m	2024/25 budget £m	2025/26 budget £m	2026/27 budget £m	2027/28 budget £m	2028/29 budget £m
Debt (incl. PFI & leases)	15.65	14.12	12.50	10.79	8.97	7.04	5.38
Capital Financing Requirement	28.04	27.08	32.32	34.02	34.62	34.22	35.82

3.5. 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.

3.6. **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

	31.3.2023 actual £m	31.3.2024 forecast £m	31.3.2025 budget £m	31.3.2026 budget £m	31.3.2027 budget £m	31.3.2028 budget £m	31.3.2029 budget £m
Forecast borrowing	8.38	7.88	7.38	6.88	6.38	5.88	5.38
Liability benchmark	(11.58)	(19.96)	(2.10)	5.08	9.35	11.45	17.45

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.

3.7. **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

	2023/24 limit £m	2024/25 limit £m	2025/26 limit £m	2026/27 limit £m	2027/28 limit £m	2028/29 limit £m
Authorised limit – borrowing	27.10	28.19	31.11	33.02	34.06	36.82
Authorised limit – PFI and leases	6.24	5.13	3.91	2.60	1.17	0.00
Authorised limit – total external debt	**33.34**	**33.32**	**35.02**	**35.62**	**35.23**	**36.82**
Operational boundary – borrowing	25.10	26.19	29.11	31.02	32.06	34.82
Operational boundary – PFI and leases	6.24	5.13	3.91	2.60	1.17	0.00
Operational boundary – total external debt	**31.34**	**31.32**	**33.02**	**33.62**	**33.23**	**34.82**

3.8. **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.

3.9. 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

	31.3.2023 actual £m	31.3.2024 forecast £m	31.3.2025 budget £m	31.3.2026 budget £m	31.3.2027 budget £m	31.3.2028 budget £m	31.3.2029 budget £m
Near-term investments	30.1	33.61	21.00	11.79	10.00	10.00	10.00
Longer-term investments	0.00	0.00	7.49	0.00	0.00	0.00	0.00
TOTAL	**30.1**	**33.61**	**28.49**	**11.79**	**10.00**	**10.00**	**10.00**

3.10. **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.

3.11. **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). Quarterly exception reports on treasury management activity are presented to the Executive Boards (Strategic Management Board (SMB) and SEB). Half-yearly reports are provided to JAC who are responsible for scrutinising treasury management decisions.

3.12. **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).

3.13. **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.

3.14. **Other 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 £1,356.0m as at 31.3.23. The cost to the Police and Crime Commissioner is the employer contribution rate, which is currently 31% (and will be increasing to 35.3% from April 2024). The reported net surplus (calculated on an asset ceiling basis) on the Staff Pension fund stood at £1.0m as at 31.3.23, this is also managed through the contribution rate which is currently set at 18.7%.

3.15. **Governance (other 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 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 11: Prudential Indicator: Proportion of financing costs to net revenue stream

	2022/23 actual £m	**2023/24 forecast £m**	**2024/25 budget £m**	**2025/26 budget £m**	**2026/27 budget £m**	**2027/28 budget £m**	**2028/29 budget £m**
Financing costs (£m)	£3.25m	£3.20m	£3.31m	£3.78m	£4.06m	£4.32m	£3.90m
Financing costs as % of net revenue stream	**1.8%**	**1.7%**	**1.7%**	**1.8%**	**1.9%**	**2.0%**	**1.8%**
Level of debt (£m)	£15.65m	£14.12m	£12.50m	£10.79m	£8.97m	£7.04m	£5.34m
Level of debt as % of net revenue stream	8.6%	7.5%	6.4%	5.4%	4.4%	3.4%	3.4%
Level of CFR as % of net revenue stream	15.6%	14.3%	16.1%	16.6%	16.4%	15.9%	16.2%

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 is 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, Wilkes 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

2022-23 Actuals £000	Description	2023-24 Revised Estimate £000	2024-25 Est £000	2025-26 Est £000	2026-27 Est £000	2027-28 Est £000	2028-29 Est £000	Total Project Costs 2023-24 to 2028-29 £000
	Estate Programme							
2	Retentions, Consultancy and QS	**23**						**23**
125	Sustainability Improvements	**100**	277	180	180	180	180	**1,097**
	Estates estimate 25-26 onwards						2,000	**2,000**
65	Re locate/ co locate/ vacate	**10**						**10**
74	Holyhead PS	**300**	5,620	485				**6,405**
73	Caernarfon & North Gwynedd Estate Area	**941**						**941**
1,717	VCC / Vehicle Workshop	**100**						**100**
	Armed Alliance							**0**
	Dolgellau PS				1,200			**1,200**
	Abergele PS	**25**	366	422				**813**
90	Llanrwst PS	**50**						**50**
	Flintshire PS - North				700	2,300		**3,000**
	Flintshire PS - South			3,700	450			**4,150**
161	Force Control Room Upgrading							**0**
	Archive Store		1,500	1,000				**2,500**
	Rhosllanerchrugog PS	**40**	150					**190**
	Prestatyn Refurb Town Center facility		400					**400**
41	Firearms Base works				2,000			**2,000**
	Firearms Base Welfare Facilities		275					**275**
	CS - SARC ISO Accreditation	**620**						**620**
2,348	**Total Building Works**	**2,209**	**8,588**	**5,787**	**4,530**	**2,480**	**2,180**	**25,774**
	Vehicles and Other Equipment							
1,528	Vehicle Purchase Replacement Programme	**2,267**	2,291	1,797	1,341	1,683	1,580	**10,959**
	PSU Vehicles (replacemnt programme)		780					**780**
	Tranman development	**60**						**60**
	Intoxilators x 3	**30**						**30**
56	ANPR replacement	**94**				200		**294**
25	Collision Surveying Equipment	**16**						**16**
1,609	**Total Vehicles and Other Equipment**	**2,467**	**3,071**	**1,797**	**1,341**	**1,883**	**1,580**	**12,139**

2022-23		2023-24	2024-25	2025-26	2026-27	2027-28	2028-29	Total
		Revised						Project
Actuals	Description	Estimate	Est	Est	Est	Est	Est	Costs
								2023-24 to
								2028-29
£000		£000	£000	£000	£000	£000	£000	£000
	Information Technology and Communication Equipment							
822	Desk Top Replacement (Replacement Programme)	**445**	2,100	1,736	1,054	820	1,350	**7,505**
	Server Replacement	**100**	320			700		**1,120**
	DFU Server replacement	**390**						**390**
	Telephony	**135**	115					**250**
275	Nexus Upgrade	**93**						**93**
	Digital Interview Recorder	**0**	450					**450**
192	NEP Device Re-build							**0**
482	Mobile data devices				645			**645**
26	NEP Infrastructure/Sail Point/Internet Links							**0**
	Digital Workplace audio visual	**86**						**86**
	Digital Intelligence & Investigation	**0**						**0**
961	Command and Control Upgrade - Phase 2	**710**	1,000				**2,900**	**4,610**
	Life-X Deployment						**1,100**	**1,100**
71	Emergency Service Network							**0**
51	Airwave replacement units	**0**	1,375					**1,375**
53	Body Worn Video (replacement costs)		1,100				**1,100**	**2,200**
2,933	**Total Information Technology and Communication**	**1,959**	**6,460**	**1,736**	**1,699**	**1,520**	**6,450**	**19,824**
6,890	**Total Capital Expenditure**	**6,635**	**18,119**	**9,320**	**7,570**	**5,883**	**10,210**	**57,737**

SUMMARY:

2022-23		2023-24	2024-25	2025-26	2026-27	2027-28	2028-29
Actuals	Description	Revised	Est	Est	Est	Est	Est
		Estimate					
£000		£000	£000	£000	£000	£000	£000
2,348	Total Building Works	2,209	8,588	5,787	4,530	2,480	2,180
1,609	Total Vehicles and Other Equipment	2,467	3,071	1,797	1,341	1,883	1,580
2,933	Total Information Technology and Communication	1,959	6,460	1,736	1,699	1,520	6,450
6,890	**Total Capital Expenditure**	**6,635**	**18,119**	**9,320**	**7,570**	**5,883**	**10,210**
	Funding						
0	Home Office Grant	620	0	0	0	0	0
3,502	Revenue Contribution	3,358	4,507	3,447	2,786	2,480	2,710
510	Earmarked Reserves	966	3,440	1,180	180	180	2,350
417	Capital Receipts	200	2,700	0	650	0	0
1,790	Borrowing for Estates	1,366	4,063	3,505	3,700	2,300	2,000
671	Borrowing for replacement programme	125	3,409	1,188	254	923	3,150
6,890	**Total Funding**	**6,635**	**18,119**	**9,320**	**7,570**	**5,883**	**10,210**
	FUNDING:						
0	External sources	620	0	0	0	0	0
4,429	Own resources	4,524	10,647	4,627	3,616	2,660	5,060
2,461	Debt	1,491	7,472	4,693	3,954	3,223	5,150
6,890	**Total Funding**	**6,635**	**18,119**	**9,320**	**7,570**	**5,883**	**10,210**

Annual Minimum Revenue Provision Statement 2024/25

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 on 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 2024/25 will not be subject to a MRP charge until 2025/26 or later.

Based on the Police and Crime Commissioner's latest estimate of its capital financing requirement (CFR) on 31st March 2024, the budget for MRP has been set as follows:

	31.03.2024 Estimated CFR £m	**2024/25 Estimated MRP £**
Capital expenditure before 01.04.2008	6.67	0.27
Capital expenditure after 31.03.2008	14.21	1.43
Leases and Private Finance Initiative	6.20	1.12
Total General Fund	**27.08**	**2.82**

APPENDIX C

Treasury Management Strategy Statement 2024/25

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 (*the below relates to data/commentary as at 04/01/24. Further weekly 'Review and Preview' emails have also been received from Arlingclose, as well as relevant daily updates).*

2.1. **Economic background:** The impact on the UK from higher interest rates and inflation, a weakening economic outlook, an uncertain political climate due to an upcoming general election, together with war in Ukraine and the Middle East, will be major influences on the Police and Crime Commissioner's treasury management strategy for 2024/25.

The Bank of England (BoE) increased Bank Rate to 5.25% in August 2023, before maintaining this level for the rest of 2023. In December 2023, members of the BoE's Monetary Policy Committee voted 6-3 in favour of keeping Bank Rate at 5.25%. The three dissenters wanted to increase rates by another 0.25%.

The November quarterly Monetary Policy Report (MPR) forecast a prolonged period of weak Gross Domestic Product (GDP) growth with the potential for a mild contraction due to ongoing weak economic activity. The outlook for CPI inflation was deemed to be highly uncertain, with upside risks to CPI falling to the 2% target coming from potential energy price increases, strong domestic wage growth and persistence in price-setting.

Office for National Statistics (ONS) figures showed CPI inflation was 3.9% in November 2023, down from a 4.6% rate in the previous month and, in line with the recent trend, lower than expected. The core CPI inflation rate declined to 5.1% from the previous month's 5.7%, again lower than predictions. Looking ahead, using the interest rate path implied by financial markets the BoE expects CPI inflation to continue falling slowly, but taking until early 2025 to reach the 2% target before dropping below target during the second half 2025 and into 2026.

ONS figures showed the UK economy contracted by 0.1% between July and September 2023. The BoE forecasts GDP will likely stagnate through 2024. The BoE forecasts that higher interest rates will constrain GDP growth, which will remain weak over the entire forecast horizon.

The labour market appears to be loosening, but only very slowly. The unemployment rate rose slightly to 4.2% between June and August 2023, from 4.0% in the previous 3-month period, but the lack of consistency in the data between the two periods made comparisons difficult. Earnings growth has remained strong but has showed some signs of easing; regular pay (excluding bonuses) was up 7.3% over the period and total pay (including bonuses) up 7.2%. Adjusted for inflation, regular pay was 1.4% and total pay 1.3%. Looking forward, the MPR showed the unemployment rate is expected to be around 4.25% in the second half of calendar 2023, but then rising steadily over the forecast horizon to around 5% in late 2025/early 2026.

Having increased its key interest rate to a target range of 5.25-5.50% in August 2023, the US Federal Reserve appears now to have concluded the hiking cycle. It is likely this level represents the peak in US rates following a more dovish meeting outcome in December 2023. US GDP grew at an annualised rate of 4.9% between July and September 2023, ahead of expectations for a 4.3% expansion and the 2.1% reading for Q2. But the impact from higher rates has started to feed into economic activity and growth will weaken in 2024. Annual CPI inflation was 3.1% in November.

Eurozone inflation has declined steadily since the start of 2023, falling to an annual rate of 2.4% in November 2023. Economic growth has been weak and GDP contracted by 0.1% in the three months to September 2023. In line with other central banks, the European Central Bank has increased rates, taking its deposit facility, fixed rate tender, and marginal lending rates to 3.75%, 4.25% and 4.50% respectively.

Credit outlook: Credit Default Swap (CDS) prices were volatile during 2023, spiking in March on the back of banking sector contagion concerns following the major events of Silicon Valley Bank becoming insolvent and the takeover of Credit Suisse by UBS. After then falling back in Q2 of calendar 2023, in the second half of the year, higher interest rates and inflation, the ongoing war in Ukraine, and now the Middle East, have led to CDS prices increasing steadily.

On an annual basis, CDS price volatility has so far been lower in 2023 compared to 2022, but this year has seen more of a divergence in prices between ringfenced (retail) and non-ringfenced (investment) banking entities once again.

Moody's revised its outlook on the UK sovereign to stable from negative to reflect its view of restored political predictability following the volatility after the 2022 mini-budget. Moody's also affirmed the Aa3 rating in recognition of the UK's economic resilience and strong institutional framework.

Following its rating action on the UK sovereign, Moody's revised the outlook on five UK banks to stable from negative and then followed this by the same action on five rated local authorities. However, within the same update the long-term ratings of those five local authorities were downgraded.

There remain competing tensions in the banking sector, on one side from higher interest rates boosting net income and profitability against another of a weakening economic outlook and likely recessions that increase the possibility of a deterioration in the quality of banks' assets.

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 2023): Although UK inflation and wage growth remain elevated, the Police and Crime Commissioner's treasury management adviser Arlingclose forecasts that Bank Rate has peaked at 5.25%. The Bank of England's Monetary Policy Committee will start reducing rates in 2024 to stimulate the UK economy but will be reluctant to do so until it is sure there will be no lingering second-round effects. Arlingclose sees rate cuts from Q3 2024 to a low of around 3% by early-mid 2026.

Arlingclose expects long-term gilt yields to be broadly stable at current levels (amid continued volatility), following the decline in yields towards the end of 2023, which reflects the expected lower medium-term path for Bank Rate. Yields will remain relatively higher than in the past, due to quantitative tightening and significant bond supply. As ever, there will undoubtedly be short-term volatility due to economic and political uncertainty and events.

A more detailed economic and interest rate forecast provided by Arlingclose is in Appendix A.

3. Local Context

3.1. On 31st March 2024, the Police and Crime Commissioner is expected to hold £7.88m of borrowing and £37.83m 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

	31.3.23 Actual £m	31.3.24 Estimate £m	31.3.25 Forecast £m	31.3.26 Forecast £m	31.3.27 Forecast £m	31.3.28 Forecast £m	31.3.29 Forecast £m
Capital financing requirement	28.04	27.08	32.32	34.02	34.62	34.22	35.82
Less: Other debt liabilities *	(7.28)	(6.24)	(5.13)	(3.91)	(2.60)	(1.17)	(0.00)
Loans CFR	**20.76**	**20.83**	**27.19**	**30.11**	**32.02**	**33.06**	**35.82**
Less: External borrowing **	(8.38)	(7.88)	(7.38)	(6.88)	(6.38)	(5.88)	(5.38)
Internal (over) borrowing	**12.39**	**12.96**	**19.81**	**23.24**	**25.65**	**27.18**	**30.44**
Less: Balance sheet resources	(42.34)	(50.79)	(39.29)	(35.03)	(32.67)	(31.61)	(28.37)
(Treasury investments) or New borrowing	**(29.95)**	**(37.83)**	**(19.47)**	**(11.79)**	**(7.02)**	**(4.43)**	**2.07**

* 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 £7.45m (which includes £5.38m 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 2024/25

3.5. **Liability benchmark:** To compare the Council'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.

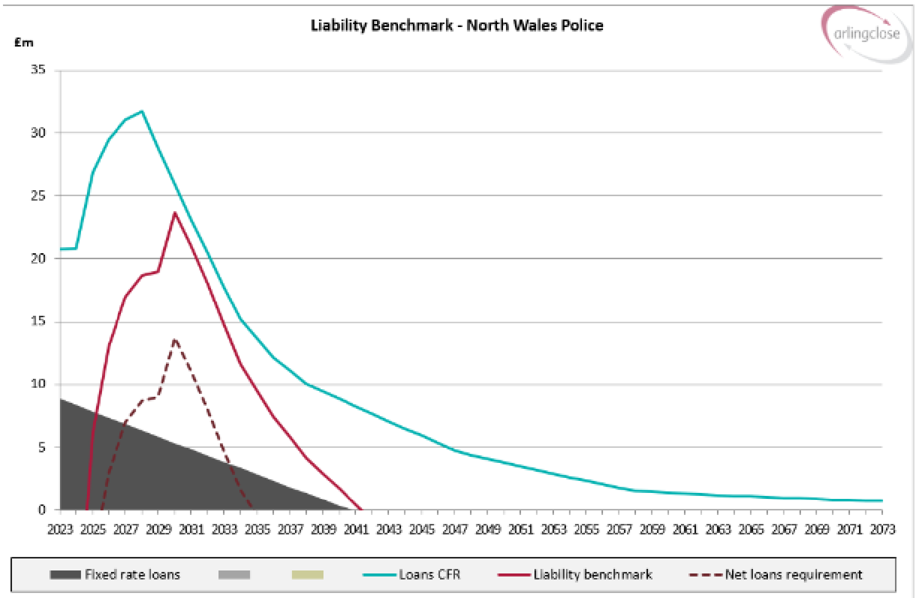
3.6. The liability benchmark is an important tool to help establish whether the Police and Crime Commissioner is likely to be a long-term borrower or long-term investor in the future, and so shape its strategic focus and decision making. The liability benchmark itself represents an estimate of the cumulative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

	31.3.23 Actual £m	31.3.24 Estimate £m	31.3.25 Forecast £m	31.3.26 Forecast £m	31.3.27 Forecast £m	31.3.28 Forecast £m	31.3.29 Forecast £m
Loans CFR	**20.76**	**20.83**	**27.19**	**30.11**	**32.02**	**33.06**	**35.82**
Less: Balance sheet resources	(42.34)	(50.79)	(39.29)	(35.03)	(32.67)	(31.61)	(28.37)
Net loans requirement	**(21.58)**	**(29.96)**	**(12.10)**	**(4.92)**	**(0.65)**	**1.45**	**7.45**
Plus: Liquidity allowance	10.00	10.00	10.00	10.00	10.00	10.00	10.00
Liability benchmark	**(11.58)**	**(19.96)**	**(2.10)**	**5.08**	**9.35**	**11.45**	**17.45**

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 £7.88 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 2024/25. 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 £33.32 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. Short-term interest rates are currently at a 15-year high but are expected to fall in the coming years and it is therefore likely to be more cost effective over the medium-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 2024/25 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)
- UK Infrastructure Bank Ltd
- 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
- retail investors via a regulated peer-to-peer platform
- 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:

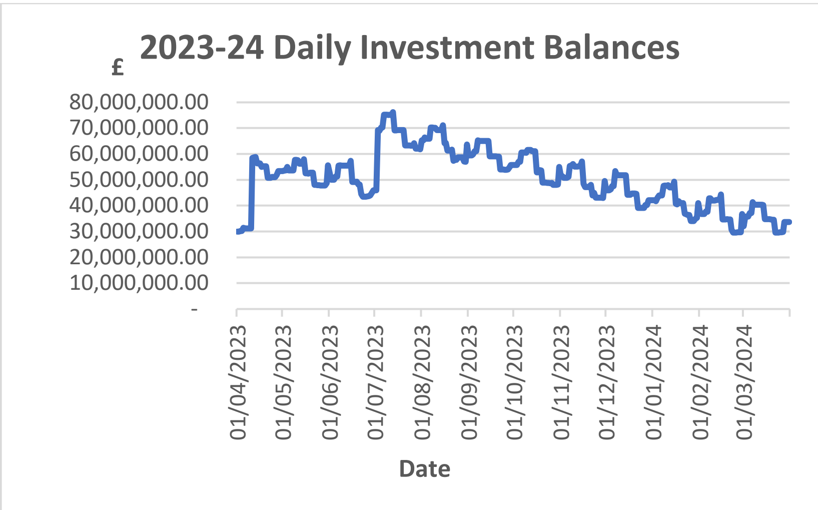
- leasing
- hire purchase
- Private Finance Initiative
- sale and leaseback

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. Financial derivatives may be used to manage this interest rate risk (see section below).

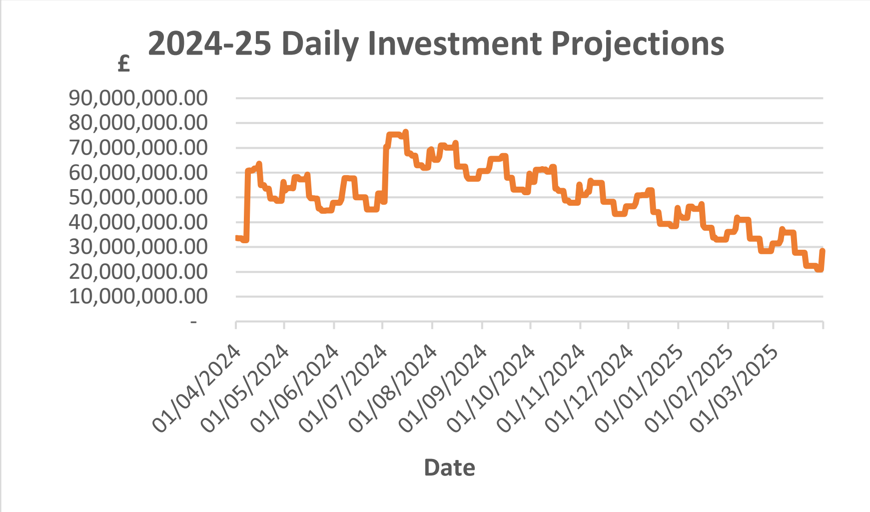
5. <u>Treasury Investment Strategy</u>

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 £29.5 million and £76.2 million (Graph 2). Projections for the forthcoming year show a similar trend with the Home Office Welsh Top-Up Grant of £23.3m being paid in one lump sum upfront in April 2024 again this year (as opposed to monthly instalments) (Graph 3).

Graph 2: Daily investment balance (2023-24)



Graph 3: Daily investment projections (2024-25)



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 new 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. The Police and Crime Commissioner has recently opened and invested in an ESG Liquidity Fund with our bankers, HSBC.

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)	Sector limit
The UK Government	Unlimited	n/a
Local authorities & other government entities	£7.5m	Unlimited
HSBC[1*]	£10m	n/a
Secured investments *	£7.5m	Unlimited
Banks (unsecured) *	£5m	Unlimited
Building societies (unsecured) *	£4m	Unlimited
Registered providers (unsecured) *	£5m	£5m
Money market funds *	£5m	Unlimited
Strategic pooled funds*	£5m	£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 considered. 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 though current accounts, collection accounts and merchant acquiring services, to any UK bank with credit ratings no lower than BBB- and with assets greater than £25 billion. These are not classed as investments but are still subject to the risk of a bank bail-in, and balances will therefore be kept below £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. **Reputational aspects:** The Police and Crime Commissioner is aware that investment with certain counterparties, while considered secure from a purely financial perspective, may leave it open to criticism, valid or otherwise, that may affect its public reputation, and this risk will therefore be taken into account when making investment decisions.

5.18. When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008, 2020 and 2022, 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 £51 million on 31st March 2024 and £39 million on 31st March 2025. 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. 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	2024/25	2025/26	2026/27
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.

8. Financial Implications

8.1. The budget for investment income in 2024/25 is £1.72 million (£0.63 million permanent budget, and £1.09 million temporary budget increase due to higher projected interest rates). The budget for debt interest paid in 2024/25 is £0.09 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 forecasted, 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 2023

Underlying assumptions:

- UK inflation and wage growth remain elevated but have eased over the past two months fuelling rate cuts expectations. Near-term rate cuts remain unlikely, although downside risks will increase as the UK economy likely slides into recession.
- The MPC's message remains unchanged as the Committee seeks to maintain tighter financial conditions. Monetary policy will remain tight as inflation is expected to moderate to target slowly, although some wage and inflation measures are below the Bank's last forecasts.
- Despite some deterioration in activity data, the UK economy remains resilient in the face of tighter monetary policy. Recent data has been soft but mixed; the more timely PMI figures suggest that the services sector is recovering from a weak Q3. Tighter policy will however bear down on domestic and external activity as interest rates bite.
- Employment demand is easing. Anecdotal evidence suggests slowing recruitment and pay growth, and we expect unemployment to rise further. As unemployment rises and interest rates remain high, consumer sentiment will deteriorate. Household and business spending will therefore be weak.
- Inflation will fall over the next 12 months. The path to the target will not be smooth, with higher energy prices and base effects interrupting the downtrend at times. The MPC's attention will remain on underlying inflation measures and wage data. We believe policy rates will remain at the peak for another 10 months, or until the MPC is comfortable the risk of further 'second-round' effects has diminished.
- Maintaining monetary policy in restrictive territory for so long, when the economy is already struggling, will require significant loosening in the future to boost activity.
- Global bond yields will remain volatile. Markets are currently running with expectations of near-term US rate cuts, fuelled somewhat unexpectedly by US policymakers themselves. Term premia and bond yields have experienced a marked decline. It would not be a surprise to see a reversal if data points do not support the narrative, but the current 10-year yield appears broadly reflective of a lower medium- term level for Bank Rate.
- There is a heightened risk of fiscal policy and/or geo-political events causing substantial volatility in yields.

Forecast:

- The MPC held Bank Rate at 5.25% in December. We believe this is the peak for Bank Rate.
- The MPC will cut rates in the medium term to stimulate the UK economy but will be reluctant to do so until it is sure there will be no lingering second-round effects. We see rate cuts from Q3 2024 to a low of around 3% by early-mid 2026.
- The immediate risks around Bank Rate have become more balanced, due to the weakening UK economy and dampening effects on inflation. This shifts to the downside in the short term as the economy weakens.
- Long-term gilt yields are now substantially lower. Arlingclose expects yields to be flat from here over the short-term reflecting medium term Bank Rate forecasts. Periodic volatility is likely.

	Current	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25	Mar-26	Jun-26	Sep-26
Official Bank Rate													
Upside risk	0.00	0.00	0.25	0.25	0.50	0.50	0.50	0.50	0.50	0.75	0.75	1.00	1.00
Central Case	5.25	5.25	5.25	5.25	5.00	4.75	4.25	4.00	3.75	3.50	3.25	3.00	3.00
Downside risk	0.00	0.00	-0.25	-0.50	-0.75	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00
3-month money market rate													
Upside risk	0.00	0.00	0.25	0.25	0.50	0.50	0.50	0.50	0.50	0.75	0.75	1.00	1.00
Central Case	5.40	5.40	5.40	5.30	5.15	4.80	4.30	4.10	3.80	3.50	3.25	3.05	3.05
Downside risk	0.00	0.00	-0.25	-0.50	-0.75	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00
5yr gilt yield													
Upside risk	0.00	0.25	0.75	0.85	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Central Case	3.77	3.75	3.75	3.75	3.70	3.60	3.50	3.50	3.40	3.30	3.30	3.30	3.35
Downside risk	0.00	-0.25	-0.75	-0.85	-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	0.25	0.75	0.85	0.85	0.90	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Central Case	3.72	3.75	3.80	3.80	3.80	3.80	3.80	3.80	3.75	3.65	3.60	3.65	3.70
Downside risk	0.00	-0.25	-0.75	-0.85	-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	0.25	0.75	0.85	0.85	0.90	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Central Case	4.16	4.20	4.20	4.20	4.20	4.20	4.20	4.20	4.20	4.20	4.20	4.20	4.25
Downside risk	0.00	-0.25	-0.75	-0.85	-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	0.25	0.75	0.85	0.85	0.90	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Central Case	3.76	3.80	3.85	3.90	3.90	3.90	3.90	3.90	3.90	3.90	3.95	3.95	3.95
Downside risk	0.00	-0.25	-0.75	-0.85	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00

PWLB Standard Rate = Gilt yield + 1.00%
PWLB Certainty Rate = Gilt yield + 0.80%
PWLB HRA Rate = Gilt yield + 0.40%
UK Infrastructure Bank Rate = Gilt yield + 0.40%

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). Reports on treasury management activity are presented to The Strategic Executive Board (SEB) and JAC. The JAC is responsible for scrutinising treasury management decisions.