



**The Nottinghamshire Office of the Police & Crime  
Commissioner**

**Treasury Management Strategy Statement**  
Minimum Revenue Provision Policy Statement and  
Annual Investment Strategy

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2015-16

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# 1. INTRODUCTION

## 1.1 Background

The Nottinghamshire Office of the Police and Crime Commissioner (The Commissioner's Office) is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. Part of the treasury management operation is to ensure that this cash flow is adequately planned, with cash being available when needed. Surplus monies are invested in low risk counterparties or instruments commensurate with the Police and Crime Commissioner's low risk appetite, providing adequate liquidity initially before considering investment return.

The second main function of the treasury management service is the funding of the Commissioner's capital plans. These capital plans provide a guide to borrowing need, and longer term cash flow planning to ensure that the The Commissioner's Office can meet its capital spending obligations. This management of longer term cash may involve arranging long or short term loans. If advantageous debt previously borrowed may be restructured to meet The Commissioner's Office risk or cost objectives.

The responsible officer for treasury management is Chief Finance Officer to the Police & Crime Commissioner (CFO).

CIPFA defines treasury management as:

*"The management of the local authority's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."*

## 1.2 Reporting requirements

The Commissioner is required to receive and approve, as a minimum, three main reports each year, which incorporate a variety of policies, estimates and actuals.

**Prudential and treasury indicators and treasury strategy** (this report) - The first, and most important report covers:

- the capital plans, prudential indicators and borrowing plans.
- a minimum revenue provision (MRP) policy (how residual capital expenditure is charged to revenue over time).

- the treasury management strategy (how the investments and borrowings are to be organised) including treasury indicators.
- an investment strategy (the parameters for managing investments )

**A mid-year treasury management report** – This will update the Commissioner with the capital position regarding capital, and amend prudential indicators as necessary. It also monitors whether the treasury activity is meeting the strategy and whether any policies require revision.

**An annual treasury report** – This provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

### **Scrutiny**

The responsibility for scrutiny lies with the Commissioner supported by the Audit and Scrutiny Panel. The above reports are reviewed at the Strategic Resources and Performance meetings of the Commissioner.

## **1.3 Treasury Management Strategy for 2015-2016**

The strategy for 2014-2016 covers two main areas:

### **Capital issues**

- the capital plans and the prudential indicators.
- the minimum revenue provision (MRP) policy.

### **Treasury management issues**

- the current treasury position.
- treasury indicators which limit the treasury risk and activities of the The Commissioner's Office.
- prospects for interest rates.
- the borrowing strategy.
- policy on borrowing in advance of need.
- debt rescheduling.
- the investment strategy.
- creditworthiness policy.
- policy on use of external service providers.

These elements cover the requirements of the Local Government Act 2003, the CIPFA Prudential Code, CLG MRP Guidance, the CIPFA Treasury Management Code and CLG Investment Guidance

## **1.4 Training**

The CIPFA Code requires that the responsible officer ensures that relevant personnel receive adequate training in treasury management. This especially applies to the Commissioner who is responsible for scrutiny. Training for the Commissioner was delivered in March 2014 and the Chief financial Officer to the Commissioner (CFO) has attended relevant seminars during the year. The training needs of treasury management officers are periodically reviewed.

## **1.5 Treasury management consultants**

The The Commissioner's Office uses Capita Asset Services, Treasury solutions as its external treasury management advisors.

The The Commissioner's Office recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon our external service providers.

It also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The CFO will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review.

## 2. THE CAPITAL PRUDENTIAL INDICATORS 2014-15 – 2017-18

The Commissioner's capital expenditure plans are the key driver of treasury management activity. The output of the capital expenditure plans is reflected in prudential indicators, to give an overview and confirm capital expenditure plans.

### 2.1 Capital expenditure

This prudential indicator is a summary of the Commissioner's capital expenditure plans, both those agreed previously, and those forming part of this budget cycle.

The Commissioner is asked to approve the capital expenditure forecasts, excluding other long term liabilities, such as Private Finance Initiatives (PFI) and leasing arrangements, which already include borrowing instruments.

The table below summarises the capital expenditure plans and how these plans are being financed by capital or revenue resources. Any shortfall of resources results in a net financing need.

<b>Capital Expenditure £m</b>	<b>2013-14 Actual</b>	<b>2014-15 Estimate</b>	<b>2015-16 Estimate</b>	<b>2016-17 Estimate</b>	<b>2017-18 Estimate</b>	<b>2018-19 Estimate</b>
Capital Programme	7.827	14.705	8.000	8,000	8.000	8.000
<b>Financed by:</b>						
Capital receipts	-1.922	-0.800	-3.229	-3.200	0	0
Capital grants	-2.043	-2.878	-1.800	-1.800	-1.800	-1.800
Internal resources	0	0	0	0	0	0
<b>Net financing need</b>	<b>3.862</b>	<b>11.027</b>	<b>2.971</b>	<b>3.000</b>	<b>6.200</b>	<b>6.200</b>

### 2.2 The Commissioners borrowing need (Capital Financing Requirement)

The second prudential indicator is the Capital Financing Requirement (CFR). The CFR is simply the total historic outstanding capital expenditure, which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the underlying borrowing need. Any capital expenditure above, which has not immediately been paid for, will increase the CFR.

The CFR does not increase indefinitely, as the minimum revenue provision (MRP) is a statutory annual revenue charge, which broadly reduces the borrowing need in line with each assets life.

The CFR includes any other long term liabilities (e.g. PFI schemes and finance leases). Whilst these increase the CFR, and therefore the borrowing requirement, these types of scheme include a borrowing facility and so the Commissioner is not required to separately borrow for these schemes.

The Commissioner is asked to approve the CFR projections below:

£m	2013-14 Actual	2014-15 Estimate	2015-16 Estimate	2016-17 Estimate	2017-18 Estimate	2018-19 Estimate
<b>Capital Financing Requirement</b>						
<b>Total CFR</b>	50.100	58.130	56.814	55.396	57.172	58.595
<b>Movement in CFR</b>	-	8.030	-1.316	-1.418	1.776	1.423

<b>Movement in CFR represented by</b>						
£m	2013-14 Actual	2014-15 Estimate	2015-16 Estimate	2016-17 Estimate	2017-18 Estimate	2018-19 Estimate
Net financing need for the year (above)	-	10.535	2.971	3.000	6.200	9.200
Less MRP/VRP and other financing movements	-	-2.505	-4.287	-4.418	-4.424	-4.777
<b>Movement in CFR</b>	-	8.030	-1.316	-1.418	1.776	1.423

N.B. The code does not require the reporting of downward estimated movements to CFR but information is included for completeness.

## 2.3 Minimum Revenue Provision (MRP) policy statement

The The Commissioner's Office is required to pay off an element of the accumulated General Fund capital spend each year (the CFR) through a revenue charge (the minimum revenue provision - MRP). Additional voluntary payments are also allowed. (voluntary revenue provision - VRP).

Communities and Local Government regulations have been issued which require the Commissioner to approve an MRP Statement in advance of each year. A variety of options are available to the Commissioner, as long as there is a prudent provision.

***The Commissioner is recommended to approve the following MRP Statement:***

For capital expenditure incurred before 1 April 2008, the MRP policy will be:

**Based on CFR** – MRP will be based on the CFR (option 2);

This option provides for an approximate 4% reduction in the borrowing need (CFR) each year.

From 1 April 2008 for all unsupported borrowing (including PFI and finance leases) the MRP policy will be:

**Asset life method** – MRP will be based on the estimated life of the assets, in accordance with the regulations (option 3).

This option provides for a reduction in the borrowing need over approximately the asset's life.

Repayments included in annual PFI or finance leases are applied as MRP.

## **2.4 Core funds and expected investment balances**

The application of resources (capital receipts, reserves etc.) to either capital finance or revenue purposes will reduce investments unless replaced by asset sales or revenue underspend. Detailed below are estimates of the year end resource balances and anticipated daily cashflow balances.

	<b>2013-14 Actual</b>	<b>2014-15 Estimate</b>	<b>2015-16 Estimate</b>	<b>2016-17 Estimate</b>	<b>2017-18 Estimate</b>	<b>2018-19 Estimate</b>
Fund balances / reserves	26.563	24.563	24.563	24.563	24.563	24.563
Capital receipts	1.553	3.229	3.200	-	-	-
Provisions	3.596	3.596	3.596	3.596	3.596	3.596
Other	-4.841	-4.956	-4.956	-4.956	-4.956	-4.956
<b>Total core funds</b>	<b>26.871</b>	<b>26.432</b>	<b>26.403</b>	<b>23.203</b>	<b>23.203</b>	<b>23.203</b>
<b>Working capital*</b>	<b>3.935</b>	<b>18.360</b>	<b>8.187</b>	<b>9.554</b>	<b>7.783</b>	<b>3.156</b>
<b>Under/over borrowing</b>	<b>-15.204</b>	<b>-22.370</b>	<b>-18.168</b>	<b>-16.335</b>	<b>-14.564</b>	<b>-9.937</b>
<b>Expected investments</b>	<b>15.602</b>	<b>22.422</b>	<b>16.422</b>	<b>16.422</b>	<b>16.422</b>	<b>16.422</b>

\*Working capital balances shown are estimated year end; these may be higher mid -year



## 2.5 Affordability prudential indicators

The previous sections cover the overall capital and control of borrowing prudential indicators, but within this framework prudential indicators are required to assess the affordability of the capital investment plans. These provide an indication of the impact of the capital investment plans on the Commissioners overall finances.

***The Commissioner is requested to approve the following indicators:***

## 2.6 Ratio of financing costs to net revenue stream

This indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream.

%	2013-14 Actual	2014-15 Estimate	2015-16 Estimate	2016-17 Estimate	2017-18 Estimate	2018-19 Estimate
Ratio	1.6	1.8	2.8	2.9	3.0	3.3

The estimates of financing costs include commitments and a reasonable assessment of forthcoming capital proposals.

## 2.7 Incremental impact of capital investment decisions on council tax

This indicator identifies the revenue costs associated with a reasonable assessment of forthcoming capital proposals, compared to the Commissioners existing approved commitments and current plans. The assumptions are based on current plans, but will invariably include some estimates, such as the level of Government support, which are not published over a three year period.

**Incremental impact of capital investment decisions on the band D council tax**

£	2014-15 Estimate	2015-16 Estimate	2016-17 Estimate	2017-18 Estimate	2018-19 Estimate
Ratio	0.00	6.52	7.65	9.09	12.07

### 3. BORROWING

- 3.1 The capital expenditure plans set out in Section 2 provide details of the service activity. The treasury management function ensures that the Commissioners cash is organised in accordance with the the relevant professional codes, so that sufficient cash is available to meet this service activity. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of appropriate borrowing facilities. The strategy covers the relevant treasury / prudential indicators, the current and projected debt positions and the annual investment strategy.

£m	2013-14 Actual	2014-15 Estimate	2015-16 Estimate	2016-17 Estimate	2017-18 Estimate	2018-19 Estimate
<b>External Debt</b>						
Debt at 1 April	35.415	31.689	32.553	35.439	35.854	39.401
New Borrowing	2.500	5.000	4.220	4.268	7.639	7.530
Borrowing repaid	-6.226	-4.136	-1.334	-3.853	-4.092	-1.480
Movement in borrowing	-3.726	0.864	2.886	0.415	3.547	6.050
<b>Debt as at 31 March</b>	<b>31.689</b>	<b>32.553</b>	<b>35.439</b>	<b>35.854</b>	<b>39.401</b>	<b>45.451</b>
Capital Financing Requirement	50.100	58.130	56.814	55.396	57.172	58.595
Other long-term liabilities (OLTL)	-3.207	-3.207	-3.207	-3.207	-3.207	-3.207
Underlying Borrowing Need	46.893	54.923	53.607	52.189	53.965	55.388
<b>Under / (over) borrowing</b>	<b>15.204</b>	<b>22.370</b>	<b>18.168</b>	<b>16.335</b>	<b>14.564</b>	<b>9.937</b>
<b>Investments</b>						
Investments	15.602	22.422	16.422	16.422	16.422	16.422
Change in Investments	-1.591	6.820	-6.000	-	-	-
<b>Net Debt</b>	<b>16.087</b>	<b>10.131</b>	<b>19.017</b>	<b>19.432</b>	<b>22.979</b>	<b>29.029</b>

### 3.2 Current portfolio position

The Commissioners treasury portfolio position at March 2014, with forward projections is summarised below. The table shows the actual external debt against the underlying capital borrowing need (the Capital Financing Requirement – CFR), highlighting any over or under borrowing.

Operational boundary £m	2014-15 Estimate	2015-16 Estimate	2016-17 Estimate	2017-18 Estimate	2018-19 Estimate
Total	60.000	60.000	60.000	60.000	60.000

Within the prudential indicators there are a number of key indicators to ensure that activities operate within well defined limits. One of these is that the Commissioner needs to ensure that its gross debt does not (except in the short term), exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2015-2016 and the following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes.

The CFO reports that this prudential indicator in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans, and the proposals in this budget report.

### 3.3 Treasury Indicators: limits to borrowing activity

The operational boundary. This is the limit beyond which external debt is not normally expected to exceed. In most cases, this would be a similar figure to the CFR.

The authorised limit for external debt. A further key prudential indicator represents a control on the maximum level of borrowing. This represents a limit beyond which external debt is prohibited, and this limit needs to be set or revised by the Commissioner. It reflects the level of external debt which, while not desired, could be afforded in the short term, but is not sustainable in the longer term.

***The Commissioner is requested to approve the following authorised limit:***

Authorised limit £m	2014-15 Estimate	2015-16 Estimate	2016-17 Estimate	2017-18 Estimate	2018-19 Estimate
Total	70.000	70.000	70.000	70.000	70.000

### 3.4 Prospects for interest rates

The Commissioner's Office has appointed Capita Asset Services as its treasury advisor and part of their service is to assist the Commissioner to formulate a view on interest rates. The table below gives Capita's view (December 2014).

Annual Average %	Bank Rate %	PWLB Borrowing Rates % (including certainty rate adjustment)		
		5 year	25 year	50 year
Dec 2014	0.50	2.50	3.90	3.90
Mar 2015	0.50	2.70	4.00	4.00
Jun 2015	0.75	2.70	4.10	4.10
Sep 2015	0.75	2.80	4.30	4.30
Dec 2015	1.00	2.90	4.40	4.40
Mar 2016	1.00	3.00	4.50	4.50
Jun 2016	1.25	3.10	4.60	4.60
Sep 2016	1.25	3.20	4.70	4.70
Dec 2016	1.50	3.30	4.70	4.70
Mar 2017	1.50	3.40	4.80	4.80
Jun 2017	1.75	3.50	4.80	4.80
Sep 2017	2.00	3.50	4.90	4.90
Dec 2017	2.25	3.50	4.90	4.90
Mar 2018	2.50	3.50	5.00	5.00

Until 2013, the economic recovery in the UK since 2008 had been the worst and slowest recovery in recent history. However, growth has increased during 2013 and especially during 2014, to surpass all expectations, propelled by recovery in consumer spending and the housing market. Forward surveys are currently indicating that growth prospects are strong for 2015, particularly in the services and construction sectors. However, growth in the manufacturing sector and in exports has weakened during 2014 due to poor growth in the Eurozone. There does need to be a significant rebalancing of the economy away from consumer spending to manufacturing, business investment and exporting in order for this initial stage in the recovery to become more firmly established. A downside to the economy is that wage inflation has been lower than CPI inflation which has eroded disposable income and living standards, although income tax cuts have ameliorated this to some extent.

To improve this situation, labour productivity must improve significantly to warrant increases in pay rates. In addition, the encouraging rate at which unemployment has been falling must eventually feed through into pressure for wage increases. However, the current view is that there is hidden slack in the labour market which needs to be taken up first. The counter side to this the CPI inflation is currently benefitting from downward pressure from falling crude oil prices. Although to an extent this is beneficial, negative inflation can slow economic recovery as sales are delayed in anticipation of lower prices.

The US, the main world economy, faces similar debt problems to the UK, but thanks to reasonable growth, cuts in government expenditure and tax rises, the annual government deficit has been halved from its peak without appearing to do too much damage to growth.

The Eurozone causes concerns in respect of a major crisis subsided considerably in 2013. However, the downturn in growth and inflation during the second half of 2014, and worries over the Ukraine situation, Middle East and Ebola, have led to a resurgence of those concerns as risks increase that it could be heading into deflation and a triple dip recession since 2008. Sovereign debt difficulties have not gone away and major concerns could return in respect of individual countries that do not dynamically address fundamental issues of low growth, international uncompetitiveness and the need for overdue reforms of the economy (as Ireland has done). It is, therefore, possible over the next few years that levels of government debt to GDP ratios could continue to rise to levels that could result in a loss of investor confidence in the financial viability of such countries. Counterparty risks therefore remain elevated.

This continues to suggest the use of higher quality counterparties for shorter time periods; Investment returns are likely to remain relatively low during 2015-2016 and beyond; Borrowing interest rates have been volatile during 2014 as alternating bouts of good and bad news have promoted optimism, and then pessimism, in financial markets. During July to October 2014, a building accumulation of negative news has led to an overall trend of falling rates. The policy of avoiding new borrowing by running down spare cash balances has served well over the last few years. However, this needs to be carefully reviewed to avoid incurring higher borrowing costs in later times, when authorities will not be able to avoid new borrowing to finance new capital expenditure and/or to refinance maturing debt; There will remain carrying cost for new borrowing which causes an increase in investments due to the differential in interest rates available.

### **Borrowing Strategy**

The Commissioner's Office is currently maintaining an under-borrowed position. This means that the capital borrowing need (the Capital Financing Requirement), has not been fully funded with loan debt as cash supporting reserves, balances and cash flow has been used as a temporary measure. This strategy is prudent as investment returns are low and counterparty risk is relatively high.

Against this background and the risks within the economic forecast, caution will be adopted with the 2015-2016 treasury operations. The CFO will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances:

if it was felt that there was a significant risk of a sharp FALL in long and short term rates (e.g. due to a marked increase of risks around relapse into recession or of risks of deflation), then long term borrowings will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered.

if it was felt that there was a significant risk of a much sharper RISE in long and short term rates than that currently forecast, perhaps arising a sudden increase in inflation risks, then the portfolio position will be re-appraised with the likely action that fixed rate funding will be drawn whilst interest rates are still lower than they will be in the next few years.

Any decisions will be reported to the Commissioner at the next available opportunity.

### **Treasury Management limits on activity**

There are three debt related treasury activity limits. The purpose of these are to restrain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of any adverse movement in interest rates. However, if these are set to be too restrictive they will impair the opportunities to reduce costs / improve performance.

The indicators are:

Upper limits on variable interest rate exposure. This identifies a maximum limit for variable interest rates based upon the debt position net of investments

Upper limits on fixed interest rate exposure. This gives a maximum limit on fixed interest rates;

Maturity structure of borrowing. These gross limits are sets a limit to reduce the exposure to large fixed rate sums falling due for refinancing, for both upper and lower limits.

***The Commissioner is requested to approve the following treasury indicators and limits:***

£m	2015-16	2016-17	2017-18	2018-19
<b>Interest rate exposures</b>				
	Upper	Upper	Upper	Upper
<b>Limits on fixed interest rates based on net debt</b>	100%	100%	100%	100%
<b>Limits on variable interest rates based on net debt</b>	100%	100%	100%	100%
<b>Limits on fixed interest rates:</b>				
• Debt only	100%	100%	100%	100%
• Investments only	100%	100%	100%	100%
<b>Limits on variable interest rates</b>				
• Debt only	50%	50%	50%	50%
• Investments only	100%	100%	100%	100%
<b>Maturity structure of fixed interest rate borrowing 2015-2016</b>				
	<b>Lower</b>		<b>Upper</b>	
Under 12 months	0%		30%	
12 months to 2 years	0%		40%	
2 years to 5 years	0%		50%	
5 years to 10 years	0%		70%	
10 years and above	0%		100%	

### **3.5 Policy on borrowing in advance of need**

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

Borrowing in advance will be made within the following constraints:

- It will be limited to no more than 50% of the expected increase in borrowing need (CFR) over the three year planning period; and
- Would not look to borrow more than 18 months in advance of need.

Risks associated with any borrowing in advance activity will be subject to prior appraisal and subsequent reporting through the mid-year or annual reporting mechanism.

### **3.6 Debt rescheduling**

As short term borrowing rates will be considerably cheaper than longer term fixed interest rates, there may be potential opportunities to generate savings by switching from long term debt to short term debt. However, these savings will need to be considered in the light of the current treasury position and the size of the cost of debt repayment (premiums incurred).

The reasons for any rescheduling to take place will include:

- the generation of cash savings and / or discounted cash flow savings;
- helping to fulfil the treasury strategy;
- enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

Consideration will also be given to identify if there is any potential for making savings by running down investment balances to repay debt prematurely as short term rates on investments are likely to be lower than rates paid on current debt.

All rescheduling will be reported to the Commissioner at the earliest opportunity.

### **3.7 Municipal Bond Agency**

It is likely that the Municipal Bond Agency, currently in the process of being set up, will be offering loans to Local Authorities in the near future. It is also hoped that the borrowing rates will be lower than those offered by the Public Works Loan Board (PWLB). The Commissioner intends to make use of this new source of borrowing as and when appropriate.



## **4. ANNUAL INVESTMENT STRATEGY**

### **4.1 Investment Policy**

The Commissioners investment policy has regard to the CLG's Guidance on Local Government Investments ("the Guidance") and the 2011 revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code"). The Commissioners investment priorities will be security first, liquidity second and then return.

In accordance with guidance from the CLG and CIPFA, and in order to minimise the risk to investments, the The Commissioner's Office has below clearly stipulated the minimum acceptable credit quality of counterparties for inclusion on the lending list. The creditworthiness methodology used to create the counterparty list fully accounts for the ratings, watches and outlooks published by all three ratings agencies with a full understanding of what these reflect in the eyes of each agency. Using our ratings service potential counterparty ratings are monitored on a real time basis with knowledge of any changes notified electronically as the agencies notify modifications.

The main rating agencies (Fitch, Moody's and Standard & Poor's) have, through much of the financial crisis, provided some institutions with a ratings "uplift" due to implied levels of sovereign support. More recently, in response to the evolving regulatory regime, the agencies have indicated they may remove these "uplifts". This process may commence during 2014-2015 and / or 2015-2016. The actual timing of the changes is still subject to discussion, but changes in the applied creditworthiness methodology were applied from the mid Year Treasury Management Review 2014-2015. Continuing regulatory changes in the banking sector are designed to see greater stability, lower risk and the removal of expectations of Government financial support should an institution fail.

It is important to stress that the rating agency changes do not reflect any changes in the underlying status of the institution or credit environment, merely the implied level of sovereign support that has been built into ratings through the financial crisis. The eventual removal of implied sovereign support will only take place when the regulatory and economic environments have ensured that financial institutions are much stronger and less prone to failure in a financial crisis.

Both Fitch and Moody's provide "standalone" credit ratings for financial institutions. For Fitch, it is the Viability Rating, while Moody's has the Financial Strength Rating. Due to the future removal of sovereign support from institution assessments, both agencies have suggested going forward that these will be in line with their respective Long Term ratings. As such, there is no point monitoring both Long Term and these "standalone" ratings.

Furthermore, Fitch has already begun assessing its Support ratings, with a clear expectation that these will be lowered to 5, which is defined as “A bank for which there is a possibility of external support, but it cannot be relied upon.” With all institutions likely to drop to these levels, there is little to no differentiation to be had by assessing Support ratings.

As a result of these rating agency changes, the credit element of our future methodology will focus solely on the Short and Long Term ratings of an institution. Rating Watch and Outlook information will continue to be assessed where it relates to these categories. This is the same process for Standard & Poor’s that we have always taken, but a change to the use of Fitch and Moody’s ratings

Furthermore, it is recognised that ratings should not be the sole determinant of the quality of an institution and that it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To this end the CFO will engage with its advisors to maintain a monitor on market pricing such as “credit default swaps” and overlay that information on top of the credit ratings. Other information sources used will include the financial press, share price and other such information pertaining to the banking sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.

The aim of the strategy is to generate a list of highly creditworthy counterparties which will also enable diversification and thus avoidance of concentration risk.

The intention of the strategy is to provide security of investment and minimisation of risk.

## **4.2 Creditworthiness policy**

The primary principle governing the Commissioner’s investment criteria is the security of its investments, although the yield or return on the investment is also a key consideration. After this main principle, The Commissioner will ensure that:

- It maintains a policy covering both the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security, and monitoring their security. This is set out in the specified and non-specified investment sections below; and

- It has sufficient liquidity in its investments. For this purpose it will set out procedures for determining the maximum periods for which funds may prudently be committed. These procedures also apply to the prudential indicators covering the maximum principal sums invested.

The CFO will maintain a counterparty list in compliance with the following criteria and will revise the criteria and submit them to the Commissioner for approval as necessary. These criteria are separate to that which determines which types of investment instrument are either specified or non-specified as it provides an overall pool of counterparties considered high quality which the Commissioner may use, rather than defining what types of investment instruments are to be used.

The minimum rating criteria uses the lowest common denominator method of selecting counterparties and applying limits. This means that the application of the Commissioners minimum criteria will apply to the lowest available rating for any institution. For instance, if an institution is rated by two agencies, one meets the Commissioners criteria, the other does not, and the institution will fall outside the lending criteria. Credit rating information is supplied by Capita Asset Services our treasury consultants, on all active counterparties that comply with the criteria below. Any counterparty failing to meet the criteria would be omitted from the counterparty (dealing) list. Any rating changes, rating watches (notification of a likely change), rating outlooks (notification of a possible longer term change) are provided to officers almost immediately after they occur and this information is considered before dealing. For instance, a negative rating watch applying to a counterparty at the minimum Commissioner criteria will be suspended from use, with all others being reviewed in light of market conditions.

The criteria for providing a pool of high quality investment counterparties (both specified and non-specified investments) is:

- Banks 1 - good credit quality – the Commissioner will only use banks which:
  - i. are UK banks; and/or
  - ii. and have as a minimum the following Fitch, Moody's and Standard and Poors credit ratings (where rated):
    - i. Short term – F1
    - ii. Long term – A-

- Banks 2 – Part nationalised UK banks – Lloyds Banking Group and Royal Bank of Scotland. These banks can be included if they continue to be part nationalised or they meet the ratings in Banks 1 above.
- Banks 3 – The Commissioners own banker for transactional purposes if the bank falls below the above criteria, although in this case balances will be minimised in both monetary size and time.
- Bank subsidiary and treasury operation -. The Commissioner will use these where the parent bank has provided an appropriate guarantee or has the necessary ratings outlined above.

**The above are limited to £5m for up to 3 months under current market conditions. Where the financial markets start to make an improvement the duration of the investment can be increased with the CFO's prior approval, under delegated powers, to no more than 12 months.**

**Where the Bank is A rated (long term) (lowest common denominator) this is limited to £2m for up to 100 days.**

- Building societies will be used if it meets the ratings for banks outlined above.
- Money market funds with instant access – Limited to £7m in any one MMF, with delegated authority for the CFO to approve temporary increase to £10m.
- Enhanced money market funds with up to 7 day notice access - Limited to £3m in any one MMF, with delegated Authority for the CFO to approve temporary increase to £5m.
- UK Government (including gilts and the DMADF) - up to a limit of £10m up to 12 months.
- Local authorities, parish councils, other Police & Crime Commissioners etc - Limited to £5m with each for up to 2 years. The CFO under delegated authority can extend either the duration or the financial limit in specific cases.

**Country and sector considerations** - Due care will be taken to consider the country, group and sector exposure of the Commissioners investments. In part, the country selection will be chosen by the credit rating of the sovereign state in Banks 1 above. In addition:

- no more than 25%/£5m will be placed with any non-UK country at any time;
- limits in place above will apply to a group of companies;
- sector limits will be monitored regularly for appropriateness.

**Use of additional information other than credit ratings.** Additional requirements under the Code require the Commissioner to supplement credit rating information. Whilst the above criteria relies primarily on the application of credit ratings to provide a pool of appropriate counterparties for officers to use, additional operational market information will be applied before making any specific investment decision from the agreed pool of counterparties. This additional market information (for example Credit Default Swaps, negative rating watches/outlooks) will be applied to compare the relative security of differing investment counterparties.

**Time and monetary limits applying to all investments.** The time and monetary limits for institutions on the Commissioners counterparty list are as follows .

	Fitch Long term Rating (or equivalent)	Money and/or % Limit	Time Limit
Banks 1 higher quality	AAA	£5m	1 yr
Banks 1 medium quality	AA-	£5m	1 yr
Banks 1 medium/lower quality	A	£4m	6 month
Banks 1 Lower quality	A-	£3m	100 days
Banks 2 – part nationalised	N/A	£5m	1yr
Banks 3 category – Commissioners banker (not meeting Banks 1)	AA	£5m	1 day
UK Govt - DMADF	AAA	Unlimited	6 months
Local authorities	N/A	£5m	2 yr
Enhanced money market funds with instant access	AAA	£5-10m	liquid
Enhanced money market funds with notice	AAA	£3-5m	liquid

### 4.3 Country Limits

The Commissioner has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of AA- from Fitch. This list will be added to, or deducted from, by officers should ratings change in accordance with this policy.

## Approved countries for investments -

*Based on lowest available rating*

AAA	AA	A	AA-
Australia Canada Denmark Germany Luxembourg Norway Singapore Sweden Switzerland	Finland Hong Kong Netherlands U.K. U.S.A.	Abu Dhabi (UAE) France Qatar	Belgium Saudi Arabia

### 4.4 Investment Strategy

**In-house funds.** Investments will be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months).

**Investment returns expectations.** Bank Rate is forecast to remain unchanged at 0.5% before starting to rise from quarter 2 of 2015. Bank Rate forecasts for financial year ends (March) are:

- 2015-2016 1.00%
- 2016-2017 1.50%
- 2017-2018 2.50%

There are downside risks to these forecasts (i.e. start of increases in Bank Rate occurs later) if economic growth weakens. However, should the pace of growth quicken, there could be an upside risk.

The suggested budgeted investment earnings rates for returns on investments placed for periods up to 100 days during each financial year for the next four years are as follows:

- 2015-2016 0.90%
- 2016-2017 1.50%
- 2017-2018 2.00%
- 2018-2019 2.50%

**Investment treasury indicator and limit** - total principal funds invested for greater than 364 days. These limits are set with regard to liquidity requirements and to reduce the need for early sale of an investment, and are based on the availability of funds after each year-end.

***The Commissioner is requested to approve the treasury indicator and limit:***

Maximum principal sums invested > 364 days				
£m	2014-2015	2015-2016	2016-2017	2017-2018
Principal sums invested > 364 days	5.000	5.000	5.000	5.000

For its cash flow generated balances, the The Commissioner's Office will seek to utilise its business reserve instant access and notice accounts, money market funds and short-dated deposits (overnight to 100 days) in order to benefit from the compounding of interest.

#### **4.5 Investment Risk Benchmarking**

These benchmarks are simple guides to maximum risk, so they may be breached from time to time, depending on movements in interest rates and counterparty criteria. The purpose of the benchmark is that officers will monitor the current and trend position and amend the operational strategy to manage risk as conditions change. Any breach of the benchmarks will be reported, with supporting reasons in the mid-year or Annual Report.

**Security** - The Commissioners maximum security risk benchmark for the current portfolio, when compared to these historic default tables, is:

- 0.06% historic risk of default when compared to the whole portfolio.

**Liquidity** – in respect of this area the Commissioner seeks to maintain:

- Bank overdraft - £0.5m maximum
- Liquid short term deposits of at least £2.0m available on instant access.
- Weighted average life benchmark is expected to be 1 month, with a maximum of 6 months.

**Yield** - local measures of yield benchmarks are:

- Investments – internal returns above the 7 day LIBID rate

#### **4.6 End of year investment report**

At the end of the financial year, the CFO will report on the investment activity as part of its Annual Treasury Report.

## **5. THE TREASURY MANAGEMENT ROLE OF THE SECTION 151 OFFICER**

The S151 (responsible) officer is the Chief Financial Officer to the Commissioner. ( CFO ) is responsible for the following:

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