Report of the Chief Financial Officer for the Police and Crime Commissioner (PCC) to the PCC
17th February 2014

Status: For Decision

Treasury Management and Prudential Indicators 2014/18

1. Purpose

To comply with the CIPFA Prudential Code of Practice, the PCC is required to set a range of Prudential Indicators for the financial year 2014/15. The code states that Prudential Indicators for Treasury Management should be considered together with the Annual Investment Strategy for 2014/15. The content of this report addresses this requirement.

2. Recommendations

The PCC is asked to:

2.1 Approve the Prudential Indicators, set out in 3.5, 3.6 and 3.7.

2.2 Approve the Annual Investment Strategy set out at Appendix A.

2.3 Approve the Treasury Management Policy in Appendix C.

2.4 Note that future investments will be placed in line with the strategy in Appendix A.

2.5 Approve that an overdraft of up to £5m can continue to be used with NatWest Bank and used as a form of temporary borrowing to manage the short-term timing differences between cash payments and receipts.

3. Reasons

3.1 Prudential Indicators

The Prudential Code requires authorities (including the PCC) to self regulate the affordability, prudence and sustainability of their capital expenditure and borrowing plans, by setting estimates and limits, and by publishing actuals, for a range of Prudential Indicators. It also requires them to ensure their Treasury Management Practices are in accordance with good practice.

3.2 The Code imposes on authorities clear governance procedures for setting and revising of Prudential Indicators, and describes the matters to which an authority will have regard when doing so. This is designed to deliver accountability in taking capital financing, borrowing and Treasury Management decisions. A fundamental provision of the Prudential Code is that over the medium term net borrowing will only be for a capital purpose.

3.3 Under the Code, individual authorities are responsible for deciding the level of their affordable borrowing, having regard to the code. Under the code The PCC are required to set a range of Prudential Indicators for the financial year 2014/15.

3.4 The code states that Prudential Indicators for Treasury Management should be considered together with the Annual Investment Strategy.

3.5 Affordability

The following indicators are required to assess the affordability of the capital investment plans. They provide an indication of the impact of the capital investment plans on overall PCC finances. The PCC is requested to approve the following:

3.5.1 Ratio of Financing Costs to Net Revenue Stream

This indicator identifies the trend in the cost of capital against the net budgetary requirement.

In 2014/15 the actual cost in this area is expected to be £6,121k; however of this, £4,222k is attributable to our PFI's (£3,162k of interest charges and £1,060k of MRP). These PFI charges are essentially covered by separate PFI Grants totalling £4,109k.

Financing Costs to Net Revenue Streams	**2014/15** Estimate	**2015/16** Estimate	**2016/17** Estimate	**2017/18** Estimate
	£000	£000	£000	£000
Minimum Revenue Provision (MRP)	2,157	1,901	1,950	2,333
Interest Payable on Borrowing	4,014	3,739	3,610	3,593
Interest Receivable	(50)	(100)	(50)	(50)
Financing Costs	**6,121**	**5,540**	**5,509**	**5,876**
Net Revenue Stream	**126,221**	**121,739**	**119,383**	**117,892**
Ratio %	4.8%	4.6%	4.6%	5.0%

Given that funding for PFI's is dealt with by a separate specific grant then the underlying level of funding that will be set aside to service borrowing (excluding PFI's) in 2014/15 will be 1.5% of our Net Revenue Stream, as per the table below:

Financing Costs to Net Revenue Streams (Excluding PFI)	**2014/15** Estimate	**2015/16** Estimate	**2016/17** Estimate	**2017/18** Estimate
	£000	£000	£000	£000
Minimum Revenue Provision (MRP)	1,097	1,102	1,107	1,111
Interest Payable on Borrowing	852	794	749	686
Interest Receivable	(50)	(100)	(50)	(50)
Financing Costs	**1,899**	**1,796**	**1,805**	**1,747**
Net Revenue Stream	**126,221**	**121,739**	**119,383**	**117,892**
Ratio %	1.5%	1.5%	1.5%	1.5%

3.5.2 *Incremental Impact of Capital Investment Decisions on Band D Council Tax*

This indicator shows the incremental impact of the additional capital expenditure that is planned in the current programme on the Band D council tax.

Council Tax	**2014/15** Estimate	**2015/16** Estimate	**2016/17** Estimate	**2017/18** Estimate
	£	£	£	£
Band D Impact	(1.38)	(2.02)	(0.10)	1.23

The PCC has approved a 1.997% increase in Precept for 2014/15 and the level of Council Tax for a Band D property will increase by £3.96. However as a result of the changes to the way that the PCC is funding capital expenditure in 2014/15 and beyond there has been a reduction in the level of resources that is needed to be set aside to fund the capital programme. The impact of these decisions is that £1.38 less per Band D property is being set aside for borrowing costs than was the case in 2013-14.

3.6 Prudence

The table below summarises the Capital Programme that is also on today's agenda for approval, plus amendments for PFI expenditure as dictated by International Accounting Standards.

Capital Expenditure	**2014/15**	**2015/16**	**2016/17**	**2017/18**
	Estimate	Estimate	Estimate	Estimate
	£000	£000	£000	£000
Capital Expenditure	1,729	2,814	2,684	1,556
PFI Capital Expenditure	356	804	955	483
Total Capital Expenditure	**2,085**	**3,618**	**3,639**	**2,039**
Funded By:				
Gross Borrowing	760	760	760	760
PFI Borrowing	0	0	0	0
Other Capital Resources	1,325	2,858	2,879	1,279
%age of Expenditure funded by Borrowing	36.5%	21.0%	20.9%	37.3%

The level of borrowing need to maintain the current plans of the organisation is significantly lower than has been the case in previous years; as such the funding of capital is on a much more sustainable footing.

3.6.1 The PCC's Borrowing Need (The Capital Financing Requirement)

The Capital Financing Requirement (CFR) measures the PCC's underlying need to borrow for Capital purposes and ensures that borrowing is only undertaken to fund capital assets and not support revenue expenditure.

The PCC is asked to approve the following CFR projections:

Capital Financing Requirement	**2014/15** Estimate	**2015/16** Estimate	**2016/17** Estimate	**2017/18** Estimate
	£000	£000	£000	£000
Opening Capital Financing Requirement	**17,950**	**18,072**	**18,189**	**18,301**
Supported Borrowing	760	760	760	760
MRP on Supported Borrowing	(638)	(643)	(648)	(652)
Closing Capital Financing Requirement	**18,072**	**18,189**	**18,301**	**18,409**
Unsupported borrowing to fund Capital Expenditur	9,546	9,546	9,546	9,546
PFI Borrowing	34,978	34,978	34,978	34,978
Total CFR Base on which MRP is calculated	**62,596**	**62,713**	**62,825**	**62,933**
MRP on Unsupported Borrowing	(1,593)	(2,052)	(2,511)	(2,969)
MRP on PFI	(7,372)	(8,171)	(9,014)	(10,236)
Total CFR Base for borrowing purposes	**53,631**	**52,490**	**51,301**	**49,728**

The Gross Borrowing requirement detailed in the table in 3.6 above increases the CFR. The PCC is required to make a statutory charge to revenue for the repayment of supported debt (the Minimum Revenue Provision) and this reduces the CFR.

3.6.2 *Limits to Borrowing Activity*

Within the Prudential indicators there are a number of indicators to ensure that the PCC operates its activities within well defined limits.

For the first of these the PCC needs to ensure that its total borrowing net of any investments 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 2014/15 and the following two financial years. This allows some flexibility for limited early borrowing for future years, to take advantage of market opportunities and to build in budget uncertainty.

Net Borrowing and the Capital Financing Requirement (CFR)	**2014/15**	**2015/16**	**2016/17**	**2017/18**
	Estimate	Estimate	Estimate	Estimate
	£000	£000	£000	£000
Borrowing	20,600	19,260	18,160	16,416
PFI Borrowing	27,606	26,807	25,964	24,742
Investments	(4,000)	(4,000)	(4,000)	(4,000)
Net Borrowing	**44,206**	**42,067**	**40,124**	**37,158**
Total CFR Base for borrowing purposes	**53,631**	**52,490**	**51,301**	**49,728**

The projected forecasts detailed in the table above show that there is still some margin between this and the CFR and therefore the PCC will be well within the limits required.

3.6.3 A further two prudential indicators control or anticipate the overall level of borrowing. These are:

- The ***Authorised Limit*** which represents the limit beyond which borrowing is prohibited and needs to be set and revised by the PCC, borrowing beyond this limit would be ultra vires. The provision for temporary borrowing within this limit has been increased in order to allow for any potential borrowing as a result of forthcoming decisions around the potential relocation of Cleveland Police Headquarters.

- The ***Operational Boundary*** which is based on the probable external debt during the course of the year. It includes scope for borrowing for revenue purposes that may be required in the short term during the year, if for instance a large grant payment was delayed. Within this, the Provision for Temporary Borrowing is requested to be £5,000k.

The PCC is asked to approve the following limits:

Authorised Limit for External Debt	**2014/15** Estimate	**2015/16** Estimate	**2016/17** Estimate	**2017/18** Estimate
	£000	£000	£000	£000
Borrowing	20,600	19,260	18,160	16,416
PFI Borrowing	27,606	26,807	25,964	24,742
Provision for Temporary Borrowing	12,000	12,000	12,000	7,000
	60,206	**58,067**	**56,124**	**48,158**

Operational Boundary for External Debt	**2014/15** Estimate	**2015/16** Estimate	**2016/17** Estimate	**2017/18** Estimate
	£000	£000	£000	£000
Borrowing	20,600	19,260	18,160	16,416
PFI Borrowing	27,606	26,807	25,964	24,742
Provision for Temporary Borrowing	5,000	5,000	5,000	5,000
	53,206	**51,067**	**49,124**	**46,158**

3.7 <u>Treasury Management Indicators</u>

The purpose of these is to contain the activity of the Treasury function within certain limits, thereby reducing the risk or likelihood of an adverse movement in interest rates or borrowing decisions impacting negatively on the PCC's overall financial position. The PCC is asked to approve the indicators below:

3.7.1 <u>Upper Limits on Borrowing</u>

This indicator identifies a maximum level of borrowing that can be made at Fixed and Variable interest rates.

Borrowing	**2014/15** Estimate	**2015/16** Estimate	**2016/17** Estimate	**2017/18** Estimate
	%	%	%	%
Upper Limit on Fixed Interest Rate Exposures	100	100	100	100
Upper Limit of Variable Rate Exposures	25	25	25	25

This means 75%-100% of our borrowing will be at rates fixed until the loan is repayable, while no more than 25% will be at variable rates so liable to change at short notice.

The PCC's use of variable rate loans previously is as a result of the potential use of the overdraft facility that is referenced elsewhere within this report.

3.7.2 Upper Limits on Investments

This indicator identifies a maximum level of investments that can be made at Fixed and Variable interest rates.

Investments	**2014/15** Estimate	**2015/16** Estimate	**2016/17** Estimate	**2017/18** Estimate
	%	%	%	%
Upper Limit on Fixed Interest Rate Exposures	100	100	100	100
Upper Limit of Variable Rate Exposures	20	20	20	20

This means 80%-100% of our investments will be at rates fixed until the investment matures, while no more than 20% will be at variable rates so liable to change at short notice.

The PCC has not entered into any variable rate investments previously and there is no intention to do so in the future. However, the indicator provides some flexibility should the need ever arise.

3.7.3 Maturity Structure of Debt

These gross limits are set to reduce the PCC's exposure to large fixed rate sums falling due for re-financing within a short timeframe. Upper and lower limits are required which the PCC is asked to approve.

Maturity Structure of Debt	**2014/15**		**2015/16**		**2016/17**		**2017/18**	
	Lower	Upper	Lower	Upper	Lower	Upper	Lower	Upper
Under 12 months	0%	50%	0%	50%	0%	50%	0%	50%
Over 12 months and under 2 years	0%	50%	0%	50%	0%	50%	0%	50%
Over 2 years and under 5 years	0%	50%	0%	50%	0%	50%	0%	50%
Over 5 years and under 10 years	0%	85%	0%	85%	0%	85%	0%	85%
Over 10 years	0%	100%	0%	100%	0%	100%	0%	100%

3.7.4 Upper Limit for Sums Invested for a Period of over 364 days

Principal Sums Invested > 1yr	**2014/15** Estimate	**2015/16** Estimate	**2016/17** Estimate	**2017/18** Estimate
	£000	£000	£000	£000
Maturity Profile	2,000	2,000	2,000	2,000

This indicator sets a limit on the level of investments that can be made for more than 364 days. The PCC is asked to approve that we do not invest more than £2m for a period of greater than 1 year.

3.8 Annual Investment Strategy

The proposed Annual Investment Strategy for 2014/2015 is attached at Appendix A. This includes the criteria for inclusion on the Counterparty List and also how this is split between Specified and Non-specified Counterparties.

3.9 Returns on Investments

While returns on investments are of secondary importance to the security of the sums invested, it is still important to consider the potential impact of approving the Investment Strategy put forward. The limited number of counterparties on our list potentially restricts the returns, in the form of interest receivable, which the PCC can make.

3.10 Given the current low level of interest rates, the Bank of England Base rate is currently 0.5% and has been for almost 4 years, the impact will be relatively small. The budget set for interest receivable in 2014/15 is £50k.

3.11 Counterparty Limits

As per the strategy in Appendix A, limits for specified counterparties are:

- The maximum investment with any counterparty is £7 million.
- The maximum investment in any one group (i.e. a bank and its wholly-owned subsidiaries) is £10 million.

3.12 For non-specified counterparties these are:

- The maximum investment with any counterparty is £5 million.
- The maximum investment in any one group (i.e. a bank and its wholly-owned subsidiaries) is £7 million.

4. Implications

4.1 Finance

There are no financial implications arising from this report that is not included above.

4.2 Diversity & Equal Opportunities

There are no issues arising from this report to bring to the PCC's attention.

4.3 Human Rights Act

There are no Human Rights Act implications arising from this report.

4.4 Sustainability

This report is part of the process to establish sustainable annual and medium term financial plans and maintain prudent financial management.

4.5 Risk

The investment strategy put forward today seeks to minimise the risks of the PCC while ensuring that the cash balances of the PCC are managed in line with proper practice and to ensure funds are available to make payments at the correct time.

5. Conclusions

5.1 To comply with the CIPFA Prudential Code of Practice the PCC is required to set a range of Prudential Indicators for the financial year 2014/15.

5.2 The CIPFA code does not set benchmark indicators. Each organisation must use its judgement when setting indicators.

5.3 Based on the indicators proposed above, the revenue budget, capital programme and associated financing are within prudent limits.

5.4 A prudent Investment Strategy has been put forward for approval that seeks to firstly secure the money being invested before secondly looking at rates of return.

Michael Porter
CFO for the PCC

APPENDIX A

PCC for Cleveland Annual Investment Strategy

The PCC for Cleveland's strategy has regard to the guidance on Local Government Investments issued in March 2004 and CIPFA's Treasury Management in Public Services 2011 Edition.

The main investment priorities are:
- The security of capital; and
- The liquidity of its investments.

The PCC for Cleveland also aims to achieve the optimum return on its investments commensurate with proper levels of security and liquidity.

The borrowing of monies purely to invest or lend to others and make a return is not lawful and the PCC for Cleveland will not engage in such activity.

The guidance on Local Government Investments sets out a range of investments which can be used and these are listed as either "specified" or "non-specified" investment categories.

In practice it is not intended that the PCC for Cleveland should depart significantly from the existing procedures, which have proven to be robust.

The guidance recognises that there has been much debate about the reliance placed by local authorities on counter parties' credit ratings. Credit ratings are an important source of information but it is important to realise that they do have limitations. Authorities are advised to have regard to the ratings issued by the three main agencies and to make their decisions on the basis of the lowest rating. Ratings should be kept under review and 'ratings watch' notices acted upon.

Credit ratings should not be relied upon in isolation to identify counterparties, but should be considered along side generally available market information. Other sources of information should be reviewed by authorities. These include the quality financial press, market data, information on government support for banks and the credit ratings of that government support.

A PCC should define what it means by a high or strong credit rating in order that its treasury management strategy is clear and its approach to risk is transparent.

Although the guidance definition of Non-Specified Investments is "one not meeting the definition of a Specified Investment", the PCC is required to identify which categories of investments are identified as prudent to use and the limits on any such investment either individually or in total. It is because some organisations do not subscribe to credit rating agencies that they have to be included as Non-Specified Investments, rather than any concern over their creditworthiness.

Limits and Definition of Specified Investments

(a) The investment is made with the UK Government or a Local Authority (as defined in the Local Government Act 2003).
(b) The investment is made with a Money Market Fund which, at the time the investment is made, has been awarded the highest credit rating, (AAA), by a credit rating agency.
(c) The investment is made with the PCC's own bank, currently NatWest.
(d) The investment is made with a Nationalised Bank or Building Society
(e) The investment is made with a Bank or Building Society that is part owned by the UK Government.

Where officers become aware of a revision of a body's rating the body should be removed from the list of Specified Investments. The PCC currently has no method of knowing about changes in ratings and has organised the Specified and Non-Specified split to avoid subscribing to one of the companies supplying monthly ratings, which would be expensive.

All Specified Investments must be denominated in sterling and must be one where the PCC may require it to be repaid or redeemed within 12 months of the date on which the investment is made. The investment must not constitute the acquisition of share capital or loan capital in any body corporate.

- The minimum % of the total of all investments which must be Specified Investments, at the time the investment is made, is 5%.
- The maximum investment with any one counterparty is £7 million.
- The maximum investment in any one group (i.e. a bank and its wholly-owned subsidiaries) is £10 million.

Limits and Definition of Non-Specified Investments

The investment is made with one of the bodies listed in Appendix B "Non Specified Investments", or the investment is for a period of one year or longer.

All Non-Specified Investments must be denominated in sterling. The investment must not constitute the acquisition of share capital or loan capital in any body corporate.

- The maximum investment with any one counterparty is £5 million.
- The maximum investment in any one group (i.e. a bank and its wholly-owned subsidiaries) is £7 million
- The maximum % of the total of all investments for a period of one year or longer, at the time the investment is made, is 10%.

Criteria for Inclusion on Investment Counterparty List

- UK Clearing Banks and their wholly owned subsidiaries. Nationalised Banks and Nationalised Building Societies.
- UK Local Authorities, Police and Crime Commissioners and nationalised industries.
- The UK Government.

Appendix B

Counterparty List

<u>Specified Investments:</u>
UK Government
Local Authorities
Other PCCs
AAA – rated Money Market Funds
NatWest Bank (The PCC's own bank)
Banks Part Owned by the UK Government
1. Lloyds Banking Group
2. Royal Bank of Scotland

<u>Unspecified Investments</u>:
- UK Clearing Banks (Not included elsewhere on the Investment List)
  1. Santander UK
  2. Bank of England
  3. Barclays
  4. Clydesdale
  5. The Co-operative Bank
  6. HSBC
  7. Nationwide
  8. Bank of Scotland