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Item No.5 (IV) **on Agenda**

Report to the Police Fire and Crime Panel – 6th February 2023

TREASURY MANAGEMENT STRATEGY REPORT 2023/2024

Report of the Staffordshire Commissioner

1. Background

1.1 In addition to the existing role overseeing Staffordshire Police, the Staffordshire Commissioner became responsible for the governance of the Staffordshire Fire and Rescue Service from August 2018. However, both remain separate organisations, with separate budgets and governance processes.

1.2 This report will detail the Treasury Management Strategy for Staffordshire Police only; a separate report has been completed for the Staffordshire Fire and Rescue Service. Therefore, reference is made only to the **Staffordshire Police and Crime Commissioner ('the Commissioner')** as part of this report.

2. Introduction

2.1 This report outlines the Commissioner's Treasury Management Strategy for 2023/24.

2.2 Treasury management comprises the management of the Commissioner's cash flows, borrowings and investments, and their associated risks. The Commissioner has borrowed and invested large sums of money and is therefore exposed to financial risks, including the effects on revenue from changing interest rates on borrowings and investments, and the risks of a potential loss of invested cash. It is important that the Commissioner successfully identifies, monitors and controls financial risk as part of prudent financial management.

2.3 The Commissioner conducts its treasury risk management within the framework of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Treasury Management in the Public Services Code of Practice 2021

Edition (the CIPFA Code). The CIPFA Code requires that the Commissioner approves a treasury management strategy before the start of each financial year. In addition, this report fulfils the legal obligation to have regard to the CIPFA Code under the Local Government Act 2003.

2.4 The Annual Investment Strategy (AIS) for 2022/23 meets the requirements of the statutory guidance issued by the Ministry of Housing, Communities and Local Government's (now referred to as Department for Levelling up, Communities and Local Government - DLUHC) in its Guidance on Local Government Investments 2018 Edition.

2.5 This strategy has been prepared in conjunction with the Treasury and Pensions team at Staffordshire County Council (SCC), after consultation with the Staffordshire Commissioner's Office and Police Finance Team.

3. Summary

3.1 The Police Fire and Crime Panel note the proposed borrowing strategy for the 2023/24 financial year. The main features are:

- to continue with the use of cash as far as practical, with the ability to raise long-term loans following consultation with the Director of Finance for the Commissioner; and
- a loan restructuring strategy that is potentially unlimited where this rebalances risk.

3.2 The Police Fire and Crime Panel note, in accordance with the DLUHC's Guidance on Local Authority Investments, the adoption of the Annual Investment Strategy (AIS) 2023/24 as detailed in **Section 7** of this report and summarised in **Appendix 3**. Also note policies on:

- reviewing the Treasury Management Strategy;
- use of external advisors; and
- investment management training.

3.3 All of the above will operate within the prudential limits set out in **Appendix 1** and will be reported to the Director of Finance at the Commissioner's Office, and reported retrospectively to the Staffordshire Police, Fire and Crime Panel, in respect of decisions made for raising new long-term loans, early loan repayments and loan rescheduling.

4. External Context

Economic Background

4.1 Against a backdrop of stubborn inflationary pressures, the easing of Covid restrictions in most developed economies, the Russian invasion of Ukraine, and a range of different UK Government policies; UK interest rates were volatile for most of 2022.

4.2 2022/23 has seen large increases in the bank base rate by the Bank of England, the Federal Reserve in the US and the European Central Bank (ECB). UK base rates rose from 0.75% in March 2021 to 3.50% in December 2022. It is expected that UK interest rates may peak at 4.5% in June 2023, as forecast by Link the County Council's independent treasury adviser, and reduce in 2024, after the Bank of England has bought inflation under control.

4.3 UK Consumer Price Inflation (CPI) for October registered +11.1%, this decreased to +10.7% in November 2022 and is forecast to reduce further in 2023 as the peak is considered to have passed. The Monetary Policy Committee (MPC) of the Bank of England saw this level of inflation as transitory, as it was principally being driven by gas prices and demand and supply chain issues, although it has lasted longer than initially forecast.

4.4 The UK unemployment rate fell to a 48-year low of 3.6% during 2022, and this was despite a net migration increase of circa 500,000. With an increase in people registered as long-term sick, the UK labour force shrunk by circa 500,000 in the year to June 2022, making it more difficult for the UK economy to grow.

4.5 Gross Domestic Product (GDP) - Q2 of 2022 saw UK GDP revised upwards to +0.2% quarter on quarter, but this was quickly reversed in Q3, with some of the fall in GDP attributed to the extra bank holiday for the late Queen's funeral. In the Bank of England's November projection, which was based on the elevated path of market interest rates, GDP is projected to continue to fall throughout 2023 and the first half of 2024, as high energy prices and tighter financial conditions weigh on spending. GDP growth is then forecast to increase by around 0.75% towards the end of 2024. Although there is judged to be a significant margin of excess demand currently, continued weakness in spending is forecast to lead to an increasing amount of economic slack emerging from the first half of next year.

4.6 Globally all the major economies are expected to struggle in the near term. The Purchasing Manager Indices for the US, EZ and China all point to at least one if not more quarters of GDP contraction.

4.7 GBP Sterling strengthened towards the end of 2022, recovering from a record low of $1.035 versus the US Dollar following the Truss government's "fiscal event" in September 2022, to $1.22. Notwithstanding the GBP's better performance in the latter part of the year, 2023 is likely to see a housing correction as some fixed-rate mortgages have moved above 5% and affordability has been squeezed despite proposed Stamp Duty cuts remaining in place.

Credit Outlook

4.8 Although bank Credit Default Swap (CDS) prices, (market indicators of credit risk), spiked upwards during the days of the Truss/Kwarteng government, they have returned to more average levels since then. However, sentiment can easily shift, so it will remain important to undertake continual monitoring of all aspects of risk and return in the current circumstances. Link (County Council's Treasury advisors) monitor CDS prices as part of their creditworthiness service which the Council has access to via an online portal.

4.9 Significant levels of downgrades to short and long-term credit ratings have not materialised from credit agencies, since the on-set of the Covid-19 crisis in March 2020. In the main, where they have changed, alterations have been limited to outlooks. However, more recently the UK sovereign debt rating has been placed on negative outlook by the three major rating agencies in the wake of the Truss/Kwarteng unfunded tax-cuts policy. Although the Sunak/Hunt government has calmed markets, the outcome of the rating agency reviews is unknown at present, but it is possible the UK sovereign debt rating will be downgraded. When setting minimum sovereign debt ratings, the Commissioner will not set a minimum rating for the UK due to the unavoidable exposure.

4.10 Looking forward, potential for bank losses remains a risk and a cautious approach to bank deposits in 2023/24 is still advisable. The Commissioner is exposed to bail-in risk, as government will no longer support banks if they fail but rather it will be the investors who primarily bear the financial burden of rescuing the bank.

Interest Rate Forecast

4.11 The Council's treasury management adviser, Link, is forecasting the Bank of England Base Rate to rise to 4.50% by June 2023 and remain at that level until the end of the year. It is then expected that rates will fall away incrementally from March 2024 and settle around 2.50% by December 2025. As with all projections there are major risks to this forecast, such as the performance of the economy versus expectations, labour and supply shortages, trade agreements and the geopolitical climate.

4.12 Gilt yields have become less volatile under the Sunak/Hunt government.
PWLB 5 to 50 years Certainty Rates are currently in the range of 3.75% to 4.50% and the medium to longer part of the yield curve is inverted to a small degree (yields are lower at the longer end of the yield curve compared to the short to medium end). Link, the Council's treasury advisors, see the markets as having already built in nearly all the effects on gilt yields of the likely increases in Bank Rate and the poor inflation outlook. Markets are, however,

volatile and further movement of gilt yields across the whole spectrum of the curve is possible.

4.13 Due to the ongoing risks outlined above, the treasury strategy retains the low-risk approach adopted in recent years, based on prioritising security, liquidity and then yield.

5. Local Context

5.1 On 30 November 2022, the Commissioner held £66.950m of external borrowing and had £45.419m temporarily invested. The Commissioner's future requirements for borrowing and investments can be considered in the context of its balance sheet forecasts described in the following paragraphs.

Balance Sheet

5.2 In terms of borrowing, the Commissioner discloses its Capital Financing Requirement (CFR) as part of its Statement of Accounts. This represents the underlying need to borrow for capital purposes i.e., the amounts that have been financed through external and internal borrowing rather than being permanently financed.

5.3 If the Commissioner increases debt to fund additional capital expenditure, this will increase its Loans CFR; conversely repaying debt through the Minimum Revenue Provision (MRP) will reduce its Loans CFR. The table below shows forecasts for the Commissioner's Loans CFR and how this will be financed through external and internal borrowing.

	31.03.22 Actual £m	31.03.23 Estimate £m	31.03.24 Forecast £m	31.03.25 Forecast £m	31.03.26 Forecast £m
Loans CFR	77.6	85.2	89.2	92.6	98.5
Less: External borrowing	(67.2)	(64.7)	(63.1)	(61.5)	(59.7)
Less: Capital financing from reserves	(4.9)	(7.4)	(3.9)	(2.6)	(2.2)
Internal / (over) borrowing	**5.5**	**13.1**	**22.2**	**28.4**	**36.6**

5.4 The table above shows that the Commissioner's Loans CFR is due to increase over the period of the TMSS due to the level of the capital programme. This will mean that despite using reserves for some of its capital financing, the Commissioner's internal borrowing requirements will increase to unsustainable levels, and further external borrowing will be required in future years. A number of existing external loans also mature during the period, further increasing the internal borrowing requirement.

5.5 CIPFA's Prudential Code for Capital Finance in Local Authorities recommends that the Commissioner's total external borrowing should be lower than its highest forecast CFR over the next three years; the previous table shows the Commissioner will comply with this recommendation in 2023/24 and going forward.

5.6 For investments, the Commissioner's total resources available are measured by its usable reserves and working capital less any amounts that have been internally borrowed. This is shown in the following table:

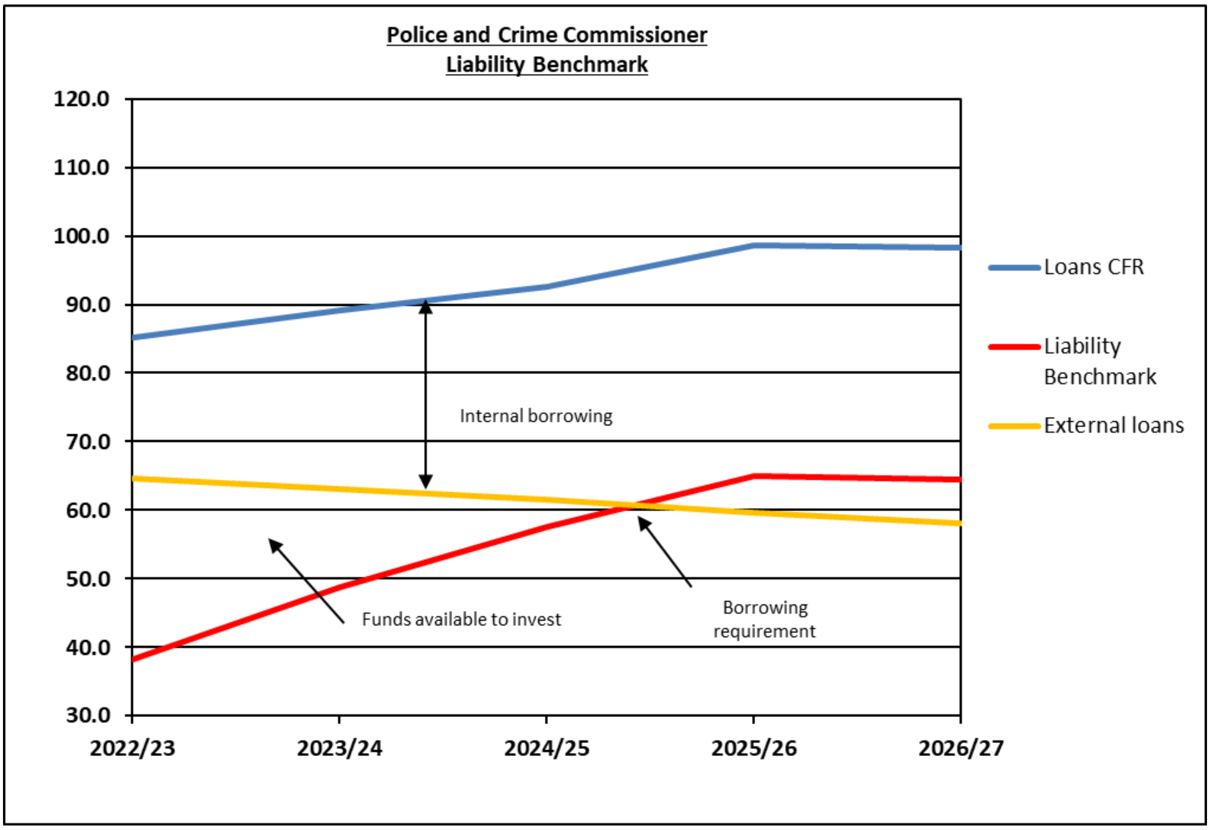
	31.03.22 Actual £m	31.03.23 Estimate £m	31.03.24 Forecast £m	31.03.25 Forecast £m	31.03.26 Forecast £m
Usable reserves	36.2	39.9	36.9	32.7	31.6
Working capital surplus	0.0	0.0	0.0	0.0	0.0
(Less Internal) / Add Over Borrowing	5.5	13.1	22.2	28.4	36.6
Investments/ (New borrowing)	**30.7**	**26.7**	**14.7**	**4.2**	**(5.0)**

5.7 This demonstrates the Commissioner's recent strategy in using internal borrowing to reduce the need for external borrowing and as a result, reduce temporary investment levels. It also indicates that the Commissioner will have sufficient internal resources to cover the internal borrowing requirement in 2023/24 and will not need to borrow from external sources during the year. However, this strategy will not be sustainable longer term as the Commissioner will not have sufficient internal resources to cover the internal borrowing requirement going forward and will need to borrow from external sources.

Liability Benchmark

5.8 The CIPFA Prudential Code requires local authorities to develop their own liability benchmark to manage treasury management risk. The liability benchmark represents the minimum amount of loans required to maintain cash balances at nil i.e., when all usable reserves and working capital surpluses are used to offset the amount of loans borrowed.

	31.03.22 Actual £m	31.03.23 Estimate £m	31.03.24 Forecast £m	31.03.25 Forecast £m	31.03.26 Forecast £m
External loans	67.2	64.7	63.1	61.5	59.7
(Less Investments) / Add New borrowing	(30.7)	(26.7)	(14.7)	(4.2)	5.0
Liability benchmark	**36.5**	**38.0**	**48.5**	**57.3**	**64.7**



5.9 The chart shows that the Commissioner's Loans CFR (blue line) has been financed through a combination of external borrowing (yellow line) and internal borrowing (the difference between the yellow line and the blue line).

5.10 The chart indicates that from 2024/25, the Commissioner's level of external loans falls below the minimum required by the liability benchmark and gap continues to widen over the period. This is due to the Commissioner's Loans CFR, and hence its liability benchmark, increasing throughout the period covered by the TMSS, driven by its capital investment. At the same time, the Commissioner's level of external loans fall during this period as several loans are repaid upon maturity.

5.11 Given these forecasts, the Commissioner will need to borrow externally as it will not have sufficient usable reserves and working capital to cover the amounts required internally. Therefore, the liability benchmark will have an impact on the Commissioner's borrowing strategy for 2023/24.

6. Borrowing strategy 2023/24

6.1 As at the 30 November 2022, the Commissioner holds £66.95m in external loans. There is a redemption of £2.250m to be paid by 31 March 2023 leaving a balance of £64.70m at the beginning of 2023/24 if no other loans are taken as part of the strategy for funding previous years capital programmes. The

Commissioner will need to ensure total amounts borrowed do not exceed the authorised limit of £90.3m, as disclosed in **Appendix 1**.

Objectives

6.2 The primary objective for the Commissioner when considering the need to borrow money is to strike an appropriate balance between securing low interest costs and achieving certainty of those costs over the period for which funds are required. Although relatively low interest costs may be secured for the short term, it is more difficult to predict interest costs over the long term.

Strategy

6.3 Given the ongoing pressures to public services and to local government funding, the Commissioner continues to address the key issue of affordability without compromising the long-term stability of its debt portfolio. As short-term interest rates have been lower than long term rates, it is more cost effective to use internal resources in lieu of borrowing in the short term.

6.4 It is important to understand that not all of the borrowing requirement needs to be closed with loans, the current economic environment still continues to favour using cash in lieu of borrowing where balances are sufficient as:

- there is a normal yield curve up to around 25 years, so it is cheaper to use cash than to borrow;
- due to bail-in legislation it is important to minimise investment risk, as using cash in lieu of borrowing reduces investment balances;
- using cash in lieu of borrowing within practical cash management limits would meet key parts of the current government guidance on local government investments, i.e., managing the security and liquidity risks for investments;
- interest rate forecasts show the Bank Rate is expected to remain above the average debt rate for the next year and beyond. Continuing to use cash in lieu of borrowing would meet the objective of bringing down the average rate of interest for borrowing and provide an opportunity to fund the capital programme at low cost.

6.5 In the past, cash balances have been sufficient to allow the strategy of using cash without the need to raise further external loans. The balance sheet analysis at **paragraph 5.6** and the liability benchmark analysis at **paragraph 5.8** both indicate the Commissioners cash balances will be lower in the coming years and consideration may be given to borrow externally.

6.6 The Commissioner will monitor the benefits of internal borrowing on a regular basis as this strategy must be balanced against the possibility that long-term borrowing costs may increase in future years, leading to additional costs incurred in deferring borrowing. Given the increase in rates during the past year it is not currently an opportune time to take out long-term borrowing unless there is an urgent requirement, although rates are not forecast to reduce considerably for some years. The Commissioner will continue to monitor its requirements for borrowing in future years consult with the treasury team at Staffordshire County Council.

6.7 The strategy proposed is one that still aims to balance the liquidity needs of day-to-day cash management with the low-risk approach that is offered by using cash.

Sources of borrowing

6.8 The approved sources of long term and short-term borrowing are:

- Public Works Loans Board (PWLB);
- UK Municipal Bonds Agency Plc and any other special purpose companies created to enable local authority bond issues;
- Other UK public sector bodies;
- UK public pension funds;
- Approved banks or building societies authorised to operate in the UK;
- Any institutions approved for investments.

Short-term loans

6.9 Short-term loans raised from money markets are typically under 6 months duration. These are low cost, and the Commissioner can respond flexibly to liquidity pressures by raising these when needed. The disadvantage of short-term loans is one of availability and it can be difficult to raise quickly from banks and building societies.

6.10 The local authority lending market has progressed considerably in recent years and funds are generally available in the short to medium term. However future availability cannot be predicted as loans raised depend upon other local authorities still having cash balances and being prepared to lend it to the Commissioner.

Long-term loans

6.11 Long-term loans are those for a duration of more than 12 months. The Commissioner has previously raised most of its long-term borrowing from the PWLB, a statutory body that issues loans to local authorities. Government consent is not ordinarily required hence the PWLB continues to be seen as the 'lender of first resort' because of the flexibility and ease of access. However local authorities are required by law to have regard to the Prudential Code and only borrow within relevant legislation and its borrowing powers.

6.12 HM Treasury have also put measures in place to prevent public bodies using PWLB funding to finance any commercial investments and there are mechanisms in place to recall such funding if this is found to be the case. In addition, the latest Prudential Code explicitly prevents Local Authorities borrowing to fund commercial ventures.

6.13 Where the Commissioner has a long-term borrowing need, it can consider the alternative sources of borrowing other than the PWLB highlighted in **paragraph 6.8**. Seeking lower interest costs may introduce greater administrative and resource costs as well as increased risk and this would need to be balanced against the ease of access to loans from the PWLB.

6.14 The exact type of loan to be raised by the Commissioner and its duration would have to be considered at the time; but with current interest rates and the maturity profile of the existing loan portfolio, loans towards the shorter end of the yield curve offer better value for money.

6.15 The optimum timing for borrowing cannot be foreseen and decisions often need to be taken at short notice. Because of this, it is proposed to delegate the decision to borrow long-term loans to the Director of Finance at the Commissioner, and reported retrospectively to the Staffordshire Police, Fire and Crime Panel. In addition, the treasury management outturn and half-year reports will update the position later in the year.

6.16 The overall strategy of maximising the use of cash in lieu of borrowing is still considered a relatively low risk strategy, although it is impossible to eliminate all treasury risk. The consequences of using cash are the possibility of increased costs in the future if interest rates rise further; this must be balanced with the extra cost now if loans are raised (the cost of carry).

<u>Loan restructuring</u>

6.17 Movements in interest rates over time may provide opportunities to restructure the loan portfolio in one of two ways:

- Replace existing loans with new loans at a lower rate (known as loan rescheduling).
- Repay loans early, without replacing the loans, although this would increase the use of cash which may not be possible given the levels of reserves available.

6.18 Market conditions have shifted in the last 12 months, and whilst Gilt yields are still comparatively low, they have risen from the historic lows seen over the last 3 years. This rise in Gilt yields means that there is a possibility that PWLB premiums may be lower than the last year and could be offset by interest savings on extinguished loans. The County Council’s treasury team shall continue to monitor the market and identify possible savings arising during 2023/24 and report this to the Director of Finance for the Commissioner. Given the level of balances forecast it is likely any loans repaid would need to be replaced.

6.19 The Commissioner's ability to adjust its loan portfolio through restructuring is only possible if:

- the Government allow it; PWLB rules have been changed in the past with no notice; or
- market conditions allow economically beneficial repayment.

6.20 Market conditions and regulations are not constant and do change and loan restructuring can only be carried out when conditions are favourable. The decision as to when to undertake loan restructuring will be delegated to the Director of Finance for the Commissioner and reported retrospectively to the Police Fire and Crime Panel.

Policy on borrowing in advanced of need

6.21 As the borrowing strategy proposed for 2023/24 involves maximising the use of cash until borrowing is required, the policy is not to borrow in advance this year. This will be revisited annually as part of the overall borrowing strategy.

7. Annual Investment Strategy (AIS) 2023/24

7.1 It is the Commissioner's borrowing strategy that determines its investment strategy. In the current economic environment, where short term investment rates are lower than borrowing rates, this still favours the use of cash instead of external borrowing, hence balances available for temporary investments are likely to be less.

7.2 The Commissioner may have significant level of funds to invest at different points of the year; this usually represents income received in advance of expenditure plus balances and reserves held. In the previous year, the Commissioner's investment balance ranged between £18.7m and £63.65m.

MiFID II

7.3 Following the introduction of the second Markets in Financial Instruments Directive (MiFID II) regulations from January 2018, local authorities will automatically be treated as retail clients by financial services firms, unless they meet the criteria and 'opt up' to be professional clients. As a retail client, the Commissioner would receive enhanced protections, but this would also mean they may face increased costs and restricted access to certain products including money market funds, pooled funds, treasury bills and treasury advice.

7.4 The commissioner meets the criteria set out under MiFID II and having chosen to 'opt-up', will continue to be treated as a professional client by regulated financial services firms in 2023/24.

Objectives

7.5 The CIPFA Code requires local authorities to invest their cash prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return or yield.

7.6 The Commissioner's objective when investing its cash is to strike an appropriate balance between risk and return, thereby minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income.

Strategy

7.7 The main characteristics which should determine an investment strategy are:
- the credit risk of the counterparties invested with;
- the length of the investment; and
- the type of financial instrument that is used.

7.8 The Commissioner has taken a low-risk approach to investment and the AIS for 2023/24 will continue to do so. The Commissioner will continue to concentrate its short-term investments in secure money market funds and government investments, together with a low-risk pooled fund in 2023/24.

7.9 DLUHC Guidance on Local Government Investments specifies the types of financial instruments that local authorities can invest in, and the Commissioner has divided its approved treasury investments into Standard Investments and Non-standard Investments.

Standard Investments

7.10 The Commissioner considers Standard Investments to be those made with approved counterparties that do not require further approval from the Director of Finance for the Commissioner. These investments tend to be for a period of less than a year and are those most frequently used by the Commissioner. Standard Investments can be invested with:
- UK Government – central government or local authority, parish council or community council.
- short term money market funds (MMFs); and
- bank and building society investments.

UK Government

7.11 The Commissioner invests with central government by using its Debt Management Account Deposit Facility (DMADF) account. Funds held in the DMADF account are backed by the UK Government, so they are very secure; however, returns may be lower than those received from elsewhere.

7.12 The Commissioner can invest in term deposits with local authorities which can provide a higher return depending on the availability of, or the need for cash, in the local authority lending market. Like central government investments, local government investments are not subject to bail in risk. However, the 'locals' market has reduced since the pandemic due to a lack of local authority borrowers.

7.13 Although investments in the local authority lending market have a low risk of insolvency, they are not completely without risk. The financial risks of a few local authorities have been documented in the press; the Commissioner will continue to monitor such developments and seek information from the County Council's Treasury team where necessary.

Money Market Funds (MMFs)

7.14 Money Market Funds have high credit quality and are pooled investment vehicles consisting of money market deposits and similar instruments. Short-term MMFs that offer same day liquidity can be used as an alternative to instant access bank accounts. Same day notice MMFs have been used by the Commissioner for some time as they have tended to provide greater security and a higher yield than bank accounts.

7.15 EU regulation, introduced in January 2019, meant most same day notice MMFs have converted from a Constant Net Asset Value (CNAV) to a Low Volatility Net Asset Value (LVNAV) structure. The assets of LVNAV MMFs are marked to market, meaning the dealing NAV (unit price) may fluctuate. However, LVNAV MMFs are allowed to maintain a constant dealing NAV provided they meet strict criteria and minimum liquidity requirements. Public debt CNAV MMFs are still available where 99.5% of assets are invested in government debt instruments.

7.16 MMFs are a key tool to manage credit and liquidity risk and the Commissioner will continue to use same day notice MMFs that meet the criteria listed below. These are considered to have sufficient high credit quality to be included on the Commissioner's Approved Lending List:

- Diversified – MMFs invest across many different investments meaning they achieve more diversification than the Commissioner could achieve on its own account:
- Short liquidity – cash can be accessed daily:
- Ring-fenced assets – the investments are owned by investors and not the fund management company: and
- Custodian – the investments are managed by an independent bank known as a custodian, who operates at arms-length from the fund management company.

7.17 Like all treasury instruments, MMFs do carry an element of risk, such as the failure of one or more of an MMF's investments could lead to a run on MMFs, especially during a financial crisis, although the new MMF regulations do limit this risk to some extent.

Bank and building society accounts

7.18 The Commissioner can make investments with banks and building societies that meet the minimum threshold **(see paragraph 7.31**) by using call accounts or term deposits, but these Investments will run the risk of credit loss via a bail in, if the regulator determines that the bank is failing or likely to fail. Due to this issue and a general cautious approach to bank and building society investments, currently the only bank or building society in use by the Commissioner is its banking provider, Lloyds Bank (see section below). Use of any further banks or building societies is delegated to the Director of Finance with the outcome reported in the regular treasury management reports to the Strategic Governance Board (Police).

Operational bank account

7.19 The Commissioner's banking provider is Lloyds Bank. Cash is retained with Lloyds Bank each night earning interest at a market rate; the amount retained will be set in line with the diversification policy set out at **paragraph 7.22** onwards.

7.20 In respect of the Bank ring-fencing legislation Lloyds Bank has a relatively small investment banking operation meaning that 97% of the bank's assets remain within the 'retail bank' ring-fence. The Commissioner's business with Lloyds Bank will take place within the 'retail bank' ring-fence (Lloyds Bank Plc) and not form part of their investment banking operations (Lloyds Bank Corporate Markets).

7.21 Should the Lloyds credit rating fall below the Commissioner's minimum threshold, then minimum balances will be retained with the bank for operational efficiency. The Commissioner will continue to seek support from the County Council's Treasury team on bank credit risk and any changes will be determined by the Director of Finance at the Commissioner.

Standard Investment diversification

7.22 Risks to investments, such as those discussed for MMFs in **paragraph 7.17**, point towards the fundamental need for diversification across counterparties and investment categories, where possible. Diversification can help to protect the security of investments by limiting the Commissioner's loss in the event of a counterparty default. Diversification will not protect the Commissioner from a systemic failure of the banking sector even if the risk of this has diminished following the bail-in banking regulations.

7.23 Diversification can be achieved by setting a maximum amount to be invested with each counterparty to limit risk and to ensure a spread of investments.

- No limits are proposed for government investments as these may be utilised for all the Commissioner's investments in certain circumstances.
- For MMF's a standard limit of £2.5m per MMF is in place to meet liquidity requirements.
- For Lloyds Bank a standard limit of £0.5m is set that minimises processing costs and provides a small amount of additional liquidity.

7.24 During 2021/22 and 2022/23, the Commissioner held additional balances throughout the year. To allow flexibility for investments, the Director of Finance for the Commissioner agreed to increase the standard limits to temporary limits of £5.0m for MMFs and £1.0m for Lloyds Bank. The Commissioner will continue to use the higher temporary limits in 2023/24 until the level of cash balances fall to allow reverting to using the standard limits.

7.25 Where cash balances are low then this may mean that all investments are placed with the MMFs and Lloyds Bank. However, balances will be within the limits stated above.

7.26 It is proposed that both the application and amendment of this policy are delegated to the Director of Finance at the Commissioner with the outcome reported in the regular treasury management reports to the Strategic Governance Board (Police).

Non-Standard Investments

7.27 The Commissioner considers Non-Standard Investments to be all other types of approved investment counterparties that are not included as part of Standard Investments i.e., those investments that are used less frequently and may require further approval from the Director of Finance for the Commissioner.

7.28 Collective Investment Schemes are Non-Standard Investments that range from enhanced MMF's to property and equity funds. These all have varying risk and return profiles. The Commissioner began to use this category of investment in 2022/23 by investing £5m to the Royal London Fund, a AAA rated enhanced Cash Plus MMF with a 3-day liquidity notice period.

7.29 The financial limit for the Royal London Cash Plus MMF had been set at £1.5m, but temporarily increased to £5m due to the current increased levels of cash balances, in line with the MMF funds as above, following approval by the Director of Finance at the Commissioner in January 2023.

The Credit Management Strategy for 2023/24

7.30 Investments made by the Commissioner should be of 'high credit quality'. Although this can be difficult to define, credit ratings can be used as published by external credit rating agencies (the three main agencies are Moody's, Standard & Poors and Fitch). Credit ratings can be obtained from the County Council's Treasury team, where available.

7.31 For 2023/24, the minimum credit-rating thresholds are set at a long-term rating of 'A- 'where available. Counterparties that are rated below this level are excluded. However, credit ratings are not the only aspect of how creditworthiness is assessed.

7.32 The following elements are also factored in when evaluating creditworthiness:

- watches" and "outlooks" from credit rating agencies
- Potential government support.
- Credit Default Swap prices (CDS) (i.e. the cost of insuring against counterparty default).
- Share prices and bond yields.
- Balance sheet structure.
- Macro-economic factors.
- A subjective overlay, i.e. a judgement being made about whether the counterparty should be recommended or not.

7.33 The Commissioner remains responsible for all its investment decisions. The County Council's Treasury team will continue to have treasury management meetings with the Commissioner on a quarterly basis where a review of the Lending List will take place.

7.34 Under stressed market conditions, additional meetings with County Council's Treasury team may take place at very short notice. A decision may be made to adjust the Commissioner's investment risk profile. This may result in moving investments to lower risk counterparties or instruments.

Non- treasury investments

7.35 Under the CIPFA Code and DLUHC Guidance, local authorities may invest in other financial assets and property for financial return, and also make loans and investments for service purposes.

7.36 Such non-treasury investments should be assessed as part of a separate commercial investment strategy. They should set out the specific policies and arrangements for non-treasury investments and ensure the same robust procedures for the consideration of risk and return are applied to these, as for treasury investments.

7.37 In the absence of any legal powers to do so the Commissioner does not currently hold any non-treasury investments and, therefore, no additional commercial investment strategy is required.

Risk

7.38 Although guidance sets out security and liquidity as being the main treasury risks, they are not the only investment risks faced by the Commissioner. **Appendix 4** sets out a high-level risk assessment for six of the key risks which are summarised in the following table:

Risk	**Assessment**
Security	Low
Liquidity	Low to Medium
Interest rate	Low to Medium
Market	Low
Refinancing	Low to Medium
Regulatory and legal	Low

7.39 Within the Commissioner's AIS there is a balance to be struck between the security of investments and liquidity; the safest investments are not necessarily the most liquid and so a pragmatic approach must be taken.

7.40 The proposed AIS has been evaluated against these risks and the most significant risks have been reduced as far as possible. This is not to say that all risk has been eliminated which is not possible in treasury terms.

8. Review of strategy

8.1 The Commissioner will prepare a revised strategy when there are significant changes to the following factors:

- the economic environment;
- the financial risk environment;
- the budgetary position; or
- the regulatory environment.

8.2 The responsibility for assessing these circumstances and proposing changes to the strategy is allocated to the Director of Finance at the Commissioner.

9. Policy on the use of external service providers

9.1 Currently the Commissioner has no contracted external treasury advisor and this is considered appropriate with the simple arrangements set out.

9.2 The treasury service for the Commissioner is provided by the County Council's Treasury team, who use Link as their external treasury management adviser. The County Council's contract with Link started in 2021 following a tender process. The Commissioner could use Link to provide consultancy advice on an ad-hoc basis should this be considered necessary.

10. Investment Management Training

10.1 Treasury management is a specialised area requiring high quality and well-trained staff that have an up-to-date knowledge of current issues, legislation and treasury risk management techniques.

10.2 The County Council's treasury team who provide the treasury service are senior qualified finance professionals. Treasury practitioners also attend regular CIPFA and treasury advisor training seminars throughout the year and have any training needs identified during the Council's staff review process. The function is also subject to regular audit and independent checks.

10.3 Training needs for Commissioner staff who attend quarterly meetings with the County Council's Treasury team are assessed on an ongoing basis by local managers.

11. SCC Memorandum of Understanding

11.1 Staffordshire County Council provides treasury management and banking services as part of a Service Level Agreement with the Commissioner. The SLA does not constitute a formal contract but is a document of good practice; it outlines the range of services provided by the County Council, and the degree of co-operation required from the Commissioner for the County Council to fulfil its role.

David Greensmith
Director of Finance

Report author
Helen Wilson
Treasury and Pension Fund
Staffordshire County Council
helen.wilson@staffordshire.gov.uk

Background Documents

1. Treasury Management in the Public Services: Code of Practice (CIPFA) (2021)
2. Prudential Code for Capital Finance in Local Authorities (CIPFA) (2021)
3. The Local Authorities (Capital Finance and Accounting) (England) Regulations 2003
4. Statutory Guidance on Local Government Investments – Issued under Section 15(1) (a) of the Local Government Act 2003 (2018)
5. Statutory Guidance on Minimum Revenue Provision – Issued under section 21 (1A) of the Local Government Act 2003 (2018)
6. Localism Act 2011 – Guidance on the General Power of Competence in sections 1 to 6.

Appendix 1

Police Fire and Crime Panel
6 February 2023
Treasury Management Indicators

Indicator	**Estimate 2023/24**	**Estimate 2024/25**	**Estimate 2025/26**
1. External debt			
a. Authorised limit	£90.3m	£94.9m	£101.3m
b. Operational boundary	£85.3m	£89.9m	£96.3m
c. External loans	£64.7m	£63.1m	£61.5m
The authorised limit is the maximum level of external borrowing which should not be exceeded. It is linked to the estimated level of borrowing assumed in the capital programme. *The operational boundary represents the Director of Finance's estimate of the day-to-day limit for treasury management activity based on the most likely i.e. prudent but not worst-case scenario.*			
2. Interest rate exposures			
a. Upper limit (fixed)	£89m	£93m	£99m
b. Upper limit (variable)	(£65m)	(£65m)	(£65m)
Upper limits of fixed and variable borrowing and investments are required to be set. This limits exposure to both fixed and variable interest rate movements as part of the overall risk management strategy for treasury management activities. Negative figures are shown in brackets; these relate to investments at a variable rate which are not offset by variable borrowings.			
3. Maturity structure of borrowing	Upper Limit	Lower Limit	
Under 12 months	10%	0%	3.7%
12 months and within 24 months	10%	0%	2.4%
24 months and within 5 years	30%	0%	7.5%
5 years and within 10 years	50%	0%	20.5%
10 years and above	100%	25%	65.8%
This indicator identifies the amount of loans maturing in specified periods. The overarching principle is that steps should be taken from a risk management point of view to limit exposure to significant refinancing risk in any short period of time. *As a result no more than 10% of fixed rate loans are planned to mature in any one financial year.*			
4. Total principal sums invested for periods longer than a year	£	£	£
Any investments made for longer than a year will be in accordance with the limits on non-specified investments.	nil	nil	nil

Police Fire and Crime Panel
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Risk assessment – Borrowing strategy

Risk	Risk description	Relevance to borrowing	Key control	Assessment	Borrowing strategy
Security	A third party fails to meet its contractual obligations (i.e., counter party risk).	Unlikely there would be a failure between the agreement to borrow and sums being received. Exposure to investment risk if borrow in advance and invested until needed.	Usually borrow from the Government (PWLB or its successor body) with 2-day gap between agreement to borrow and receipt of money.	**LOW**	Use of cash to fund debt reduces this risk. There is insufficient cash to fully fund debt so it is likely that borrowing will be required.
Liquidity	Cash is not readily available when it is needed.	Usually borrow for capital from Government (PWLB or its successor body). Can also borrow for the short-term e.g., from other local authorities.	Prudential rules on borrowing and consideration of whether Government is secure.	**LOW to MEDIUM**	Use of cash to fund debt increases this risk as liquidity is reduced when borrowing is avoided. Any increase in borrowing decreases this risk.
Interest rate	Unexpected <u>reduction</u> in short term interest rates.	Depends on the mix between fixed and variable rate borrowing. Higher exposure to variable rate borrowing helps the budget.	The control is set out below.	**LOW to MEDIUM**	Pursuing a strategy of using cash reduces the overall net exposure to sudden interest rate falls.
Interest rate	Unexpected <u>increase</u> in short term interest rates.	Depends on the mix between fixed and variable rate borrowing. Lower exposure to variable rate borrowing helps the budget.	Limit variable rate borrowing to a relatively small proportion (e.g., 20%).	**LOW to MEDIUM**	20% limit provides a suitable risk control.

Risk	Risk description	Relevance to borrowing	Key control	Assessment	Borrowing strategy
Market	The market value of loans change substantially (i.e. how much is the borrowing strategy exposed to long term interest rate change).	How much risk is built into the maturity profile of the loans structure.	This is inversely linked to refinancing risk below.	**MEDIUM**	Use of cash will shorten the duration of the loan portfolio and reduces this risk. Without the use of cash this risk assessment would probably be high.
Refinancing risk	Maturing transactions cannot be renewed on similar terms.	To avoid a high level of borrowing over a short period with exposure to high interest rates.	The PFCC has a policy of limiting maturing loans to 10% of the loans portfolio.	**MEDIUM**	Using cash to fund debt potentially increases the refinancing risk. Without the use of cash this risk assessment would probably be low.
Regulatory and legal risk	Rules governing local government borrowing are changed or amended without notice, which has happened in the recent past.	Local government heavily reliant upon PWLB or its successor body. Cost and ability to reschedule / manage loans are determined by the Government. The Government could close the PWLB or is successor body and force local authorities to use market loans for all new borrowing.	Market loans will be evaluated and will be taken if they are good overall value.	**MEDIUM**	Use of cash means that PWLB (or its successor body) loans may not be taken. However, there is insufficient cash to fully fund debt in the medium term so it is likely that borrowing will be required. If the PWLB or its successor body was closed to new business, then other loans would have to be taken.

Appendix 3

Police Fire and Crime Panel
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Lending List – January 2023	
	Time Limit
Regulation Investments	
UK Government DMADF account	6 months
UK Local Authority	12 months
Banks and building societies	
Lloyds (as banker) (£1m limit)	overnight
MMF's	
Aberdeen Standard (£5m limit)	call only
CCLA (£5m limit)	call only
Morgan Stanley (£5m limit)	call only
State Street (£5m limit)	call only
Enhanced MMF	
Royal London Cash Plus (£5m limit)	3-day notice

Appendix 4

Police Fire and Crime Panel
6 February 2023

Risk assessment - Investments

Risk	Risk description	Relevance to investment	Key control	Assessment	Approved Investment Strategy (AIS)
Security	A third party fails to meet its contractual obligations (i.e. counter party risk).	Crucial that money invested is returned (principal and interest).	Relies on credit management policy including; credit risk, duration of investment and amount as well as an ongoing review of the credit environment. Prudential limit on investment over 1 year.	**LOW**	Use of the investments identified within the AIS reduces this risk to a low level. The borrowing strategy identified will reduce cash balances and the resulting security risk. With the exception of regulation investments, counterparties also have a financial limit to ensure funds are spread amongst them. Overall this remains a low risk strategy.
Liquidity	Cash is not readily available when it is needed.	Need to plan investment to match cash requirements.	Managed through detailed cash flow forecast and investments in highly liquid funds.	**LOW to MEDIUM**	Same day access accounts are held with three MMF's. Balances are held with Lloyds Bank Plc overnight on account. Cash flow plans are completed annually and regularly updated.
Interest rate	Unexpected <u>reduction</u> in Interest rate.	Reduces the return on investment and reduces the level of reserves.	Can reduce risk by; A) netting off investment against borrowing to reduce net exposure B) investing for longer periods.	**LOW**	Investments will be mainly short term – this does not protect against an interest rate reduction. Although interest rates are expected to rise, interest rates are still at historically low levels.

Risk	Risk description	Relevance to investment	Key control	Assessment	Approved Investment Strategy (AIS)
Interest rate	Unexpected increase in interest rates.	To take advantage of the unexpected return, would need to keep investment short term and increase the amount of cash invested (e.g. by not using cash in lieu of borrowing).	Controlled through the overall strategy.	**MEDIUM**	Current policy allows upturns to be taken advantage of as investments are not fixed for long periods. Using cash to fund debt (the proposed borrowing strategy) reduces this risk as the overall exposure to short term interest rates is less.
Market	Unexpected need to liquidate market instrument quickly and accept 'price on the day'.	Only relevant if invest in market instruments (e.g. CD's, gilts).	Limit investment in market instruments or alternatively have capacity to borrow to avoid need to liquidate. Controlled by limits on non specified investments.	**LOW**	Market instruments are not in use.
Refinancing risk	Maturing transactions cannot be renewed on similar terms.	Reflected in the term (duration) of investments. Shorter term investments have a higher refinancing risk.	Proportion of investments maturing in the short term.	**LOW to MEDIUM**	The current policy is to invest in the short term. There is an increased risk with this strategy due to frequent 'refinancing' but this is only expected to be advantageous in a rising interest rate environment. Using cash to fund debt (the proposed borrowing strategy) reduces this risk as the overall exposure to short term interest rates is less.

Appendix 4 (continued)

Risk	Risk description	Relevance to investment	Key control	Assessment	Approved Investment Strategy (AIS)
Regulatory and legal risk	Rules governing local government investment powers are changed or amended without notice.	Investment powers are granted through statute and guidance.	None.	**LOW**	The current policy of using cash in lieu of borrowing reduces the authority's dependency on interest receipts. The AIS is low risk and uses liquid and conservative investment instruments.