Treasury Management & Investment Strategy

2023/24

Report of the Treasurer

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Police and Crime Commissioner
West Mercia

Recommendations

That the Joint Audit and Standards Committee supports the Treasury Management and Investment Strategy and recommends that:

a) the Treasury Management Strategy and Investment Strategy for 2023/24 be approved by the Police and Crime Commissioner

b) the Prudential Indicators agreed as part of the respective budget settings (see Appendix A) are noted;

c) the Commissioner requires the Treasurer to ensure that net borrowing does not exceed the Prudential levels specified in Appendix A, taking into account current commitments, existing plans, and the proposals agreed in the budget reports;

d) the Commissioner delegates authority to the Treasurer to undertake all the activities listed in Appendix B of the report;

e) the Treasurer implements the Minimum Revenue Provision Policy as specified in Appendix A.

1 Introduction

1.1 Background

Treasury management is defined, in a local government context, 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."

The Commissioner 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 it is needed. Surplus monies are invested in low risk counterparties or instruments commensurate with a low risk appetite, providing security of capital and sufficient liquidity initially before considering investment return. DLUHC's Investment Guidance requires local authorities and PCCs to invest prudently and give priority to security and liquidity before yield

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 the borrowing need of the Commissioner, essentially the longer term cash flow planning to ensure that the Commissioner can meet his capital spending obligations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses. On occasions, debt previously drawn may be restructured to meet the Commissioner's risk or cost objectives.

1.2 Statutory Requirements

Treasury risk management at the Force is conducted within the framework of the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice 2021 Edition* (the CIPFA Code) which requires the Force to approve a treasury management strategy before the start of each financial year. This report fulfils the Authority's legal obligation under the *Local Government Act 2003* to have regard to the CIPFA Code.

The Commissioner has a statutory obligation under the Local Government Act 2003 to have regard to the CIPFA Prudential Code and the CIPFA Treasury Management Code of Practice to set Prudential and Treasury Indicators for the next three years to ensure that the Authority's capital investment plans are affordable, prudent and sustainable.

The Commissioner is required, therefore, to set out his treasury strategy for borrowing and to prepare an Annual Investment Strategy. This sets out the policies for managing their investments and for giving priority to the security and liquidity of those investments.

1.3 CIPFA Requirements

The Chartered Institute of Public Finance and Accountancy's (CIPFA) is responsible for publishing and maintaining the Code of Practice on Treasury Management with which the Commissioner is obliged to comply.

The primary requirements of the Code are as follows:

a. Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Commissioners' treasury management activities.

b. Creation and maintenance of Treasury Management Practices which set out the manner in which the Commissioner will seek to achieve those policies and objectives.

c. Receipt by the Commissioner of an annual Treasury Management Strategy Statement - including the Annual Investment Strategy and Minimum Revenue Provision Policy - for the year ahead, a Mid-year Review Report and an Annual Report (stewardship report) covering activities during the previous year.

d. Delegation by the Commissioner of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.

e. Delegation by Commissioner of the role of scrutiny of treasury management strategy and policies to a specific named body. In this respect the Commissioner has chosen to delegate this responsibility to the Joint Audit Committee

The suggested strategy for 2023/24 in respect of the following aspects of the treasury management function is based upon the Treasurer's and the Force's Financial Accounting Team (who undertake treasury management on behalf of the Commissioner) views on interest rates, supplemented with leading market forecasts provided by treasury advisers.

The strategy covers:

- Treasury limits for 2023/24 to 2025/26
- Prudential indicators
- External and local content
- Borrowing strategy
- Debt rescheduling
- Annual investment strategy
- Minimum Revenue Provision (MRP) strategy

In accordance with the CIPFA Code the Commissioner will be asked to approve a revised Treasury Management Strategy Statement should the assumptions on which this report is based change significantly. Such circumstances would include, for example, a large unexpected change in interest rates, or in the Commissioner's capital programme or in the level of its investment balance.

1.4 Treasury Limits for 2023/24 to 2025/26

The Commissioner is required to determine and keep under review how much they can afford to borrow. The amount so determined is termed the "Affordable Borrowing Limit". In England and Wales, the Authorised Limit represents the legislative limit specified in the Local Government Act 2003.

The Commissioner must have regard to the Prudential Code when setting the Authorised Limit, which essentially requires them to ensure that total capital investment remains within sustainable limits and, in particular, that the impact upon future council tax levels is 'acceptable'.

Termed an "Affordable Borrowing Limit", the capital plans to be considered for inclusion in corporate financing consists of both external borrowing and other forms of liability, such as credit arrangements. The Authorised Limit is to be set, on a rolling basis, for the forthcoming financial year and two successive financial years. Details of the Authorised Limit can be found in Appendix A of this report.

The Commissioner's current treasury portfolio is as follows:

Treasury Portfolio at 28th February 2023	Principal £m	Average Rate %
Fixed Rate Funding Public Works Loans Board Temporary Borrowing	 44.1 0	 2.71% 0
	44.1	
Investments In House (Santander £0.0m; HSBC £4.9m) Externally Managed	 4.9 5.0	 3.90% 3.83%
	9.9	
Net Debt	(34.2)	

The Commissioner's borrowing requirement is as follows (see also section 6):

Borrowing Requirement	**21/22 actual £m**	**22/23 Estimate £m**	**23/24 Estimate £m**	**24/25 Estimate £m**	**25/26 Estimate £m**
New borrowing	5.0	10.0	27.1	16.9	7.7
Replacement borrowing	0.0	0.0	5.0	10.0	0.0
Total	**5.0**	**10.0**	**32.1**	**26.9**	**7.7**

1.5 Prudential Indicators for 2023/24 to 2025/26

Prudential and Treasury Indicators (Appendix A to this report) are relevant for the purpose of setting an integrated treasury management strategy.

The indicators are based on the currently agreed capital programme, as set out in the Budget Report.

1.6 The External & Local Context

Economic background

The ongoing impact on the UK from the war in Ukraine, together with higher inflation, higher interest rates, uncertain government policy, and a deteriorating economic outlook, will be major influences on the West Mercia Police's treasury management strategy for 2023/24.

The Bank of England (BoE) increased Bank Rate by 0.5% to 3.5% in December 2022. This followed a 0.75% rise in November which was the largest single rate hike since 1989 and the ninth successive rise since December 2021. The December decision was voted for by a 6-3 majority of the Monetary Policy Committee (MPC), with two dissenters voting for a no-change at 3% and one for a larger rise of 0.75%.

The November quarterly Monetary Policy Report (MPR) forecast a prolonged but shallow recession in the UK with CPI inflation remaining elevated at over 10% in the near-term. While the projected peak of inflation is lower than in the August report, due in part to the government's support package for household energy costs, inflation is expected remain higher for longer over the forecast horizon and the economic outlook remains weak, with unemployment projected to start rising.

The UK economy contracted by 0.3% between July and September 2022 according to the Office for National Statistics, and the BoE forecasts Gross Domestic Product (GDP) will decline 0.75% in the second half of the calendar year due to the squeeze on household income from higher energy costs and goods prices. Growth is then expected to continue to fall throughout 2023 and the first half of 2024.

CPI inflation is expected to have peaked at around 11% in the last calendar quarter of 2022 and then fall sharply to 1.4%, below the 2% target, in two years' time and to 0% in three years' time if Bank Rate follows the path implied by financial markets at the time of the November MPR (a peak of 5.25%). However, the BoE stated it considered this path to be too high, suggesting that the peak in interest rates will be lower, reducing the risk of inflation falling too far below target. Market rates have fallen since the time of the November MPR.

The labour market remains tight for now, with the most recent statistics showing the unemployment rate was 3.7%. Earnings were up strongly in nominal terms by 6.1% for both total pay and for regular pay but factoring in inflation means real pay for both measures was -2.7%. Looking forward, the November MPR shows the labour market weakening in response to the deteriorating outlook for growth, leading to the unemployment rate rising to around 6.5% in 2025.

Interest rates have also been rising sharply in the US, with the Federal Reserve increasing the range on its key interest rate by 0.5% in December 2022 to 4.25%-4.5%. This rise follows four successive 0.75% rises in a pace of tightening that has seen rates increase from 0.25%-0.50% in March 2022. Annual inflation has been slowing in the US but remains above 7%. GDP grew at an annualised rate of 3.2% (revised up from 2.9%) between July and September 2022, but with official interest rates expected to rise even further in the coming months, a recession in the region is widely expected at some point during 2023.

Inflation rose consistently in the Euro Zone since the start of the year, hitting a peak annual rate of 10.6% in October 2022, before declining to 10.1% in November. Economic growth has been weakening with an upwardly revised expansion of 0.3% (from 0.2%) in the three months to September 2022. As with the UK and US, the European Central Bank has been on an interest rate tightening cycle, pushing up its three key interest rates by 0.50% in December, following two consecutive 0.75% rises, taking its main refinancing rate to 2.5% and deposit facility rate to 2.0%.

1.7 Credit Outlook

Credit default swap (CDS) prices have generally followed an upward trend throughout 2022, indicating higher credit risk. They have been boosted by the war in Ukraine, increasing economic and political uncertainty and a weaker global and UK outlook, but remain well below the levels seen at the beginning of the Covid-19 pandemic.

CDS price volatility was higher in 2022 compared to 2021 and the divergence in prices between ringfenced (retail) and non-ringfenced (investment) banking entities has emerged once again.

The weakening economic picture during 2022 led the credit rating agencies to reflect this in their assessment of the outlook for the United Kingdom as well as several local authorities and financial institutions, revising them to negative from stable.

There are competing tensions in the banking sector which could impact bank balance sheet strength going forward. The weakening economic outlook and likely recessions in many regions increase the possibility of a deterioration in the quality of banks' assets, while higher interest rates provide a boost to net income and profitability.

However, the institutions on our adviser Arlingclose's counterparty list remain well-capitalised and their counterparty advice on both recommended institutions and maximum duration remain under constant review and will continue to reflect economic conditions and the credit outlook.

1.8 Interest Rate Forecast

The Commissioner's treasury management adviser Arlingclose forecasts that Bank Rate will continue to rise in 2022 and 2023 as the Bank of England attempts to subdue inflation which is significantly above its 2% target.

While interest rate expectations reduced during October and November 2022, multiple interest rate rises are still expected over the forecast horizon despite looming recession. Arlingclose expects Bank Rate to rise to 4.25% by June 2023 under its central case, with the risks in the near- and medium-term to the upside should inflation not evolve as the Bank forecasts and remains persistently higher.

Yields are expected to remain broadly at current levels over the medium-term, with 5-, 10- and 20-year gilt yields expected to average around 3.5%, 3.5%, and 3.85% respectively over the 3-year period to December 2025. The risks for short, medium and longer-term yields are judged to be broadly balanced over the forecast horizon. As ever, there will undoubtedly be short-term volatility due to economic and political uncertainty and events.

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

For the purpose of setting the budget, it has been assumed that new treasury investments will be made at an average rate/yield of 3.90%, and that new long-term loans will be borrowed at an average rate of 4.14%.

1.9 Local Context

It is estimated that as at the 31st March 2023 West Mercia will hold £44.1m of borrowing and £5.0m of investments. Forecast changes in these sums are shown in the balance sheet analysis table below.

Balance Sheet Summary and Forecast:

	31.03.22 Actual £m	31.03.23 Forecast £m	31.03.24 Forecast £m	31.03.25 Forecast £m	31.03.26 Forecast £m
Borrowing CFR	60.1	70.9	92.7	101.2	98.8
Less: External Borrowing**	39.2	44.1	66.2	83.3	80.9
"Internal" Borrowing	**20.9**	**26.8**	**26.5**	**17.9**	**17.9**
Less: Other debt liabilities*	0.0	0.0	0.0	0.0	0
Less: Usable Reserves	(13.4)	(14.7)	(11.6)	(11.2)	(12.2)
Plus / (Less): Working Capital	(10.3)	(17.1)	(19.9)	(11.7)	(10.7)
Investments	**(2.8)**	**(5.0)**	**(5.0)**	**(5.0)**	**(5.0)**

*leases and PFI liabilities that form part of the PCC's total debt

**shows only loans to which the Commissioner is committed and includes optional refinancing; actual external borrowing may be lower, depending on cash flow and capital spend

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

The capital expenditure plans imply that there is a need to borrow over the forecast period; it is assumed that usable reserves will remain between £11m and £12m from April 2023 onwards and that the capital programme will generally be funded from borrowing, along with any capital receipts generated from the rationalisation of the West Mercia estate.

CIPFA's Prudential Code for Capital Finance in Local Authorities recommends that the Commissioner's total debt should be lower than its highest CFR forecast.

1.10 Liability benchmark:

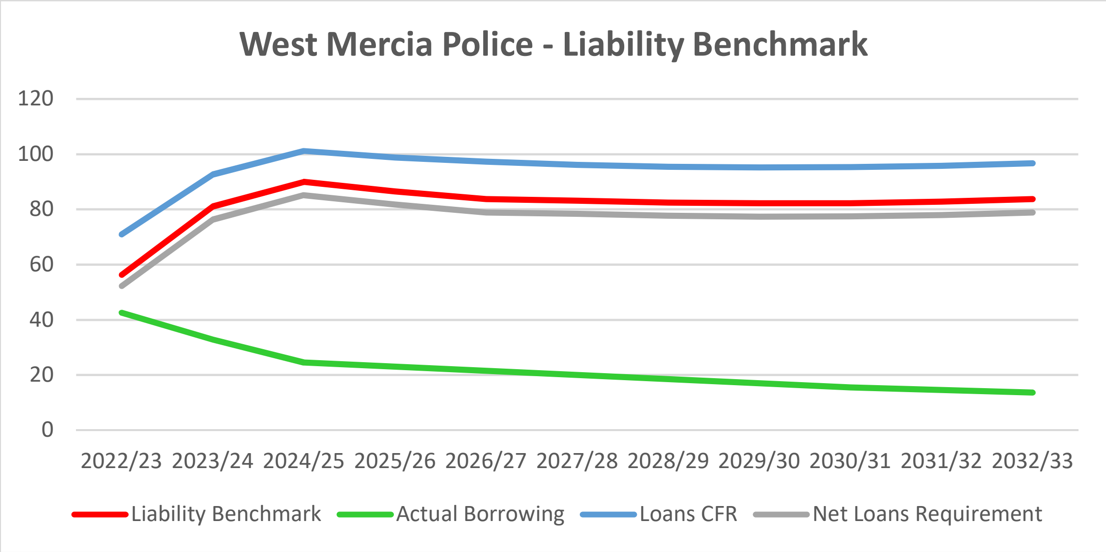
To compare the Commissioners actual borrowing against an alternative strategy, a liability benchmark has been calculated showing the lowest risk level of borrowing. This assumes the same forecasts as table 1 above, but that cash and investment balances are kept to a minimum level of £4.8m at each year-end to maintain sufficient liquidity but minimise credit risk.

The liability benchmark is an important tool to help establish whether the Commissioner is likely to be a long-term borrower or long-term investor in the future, and so shape its strategic focus and decision making. The liability benchmark itself represents an estimate of the cumulative amount of external borrowing the Commissioner must hold to fund its current capital and revenue plans while keeping treasury investments at the minimum level required to manage day-to-day cash flow.

Table 2: Prudential Indicator: Liability benchmark

	31.3.22 Actual £m	31.3.23 Estimate £m	31.3.24 Forecast £m	31.3.25 Forecast £m	31.3.26 Forecast £m
Loans CFR	70.946	92.705	101.164	98.769	97.274
Less: Balance sheet resources	18.679	16.373	15.995	16.995	18.345
Net loans requirement	52.267	76.332	85.169	81.774	78.929
Plus: Liquidity allowance	4.000	4.800	4.800	4.800	4.800
Liability benchmark	**56.267**	**81.132**	**89.969**	**86.574**	**83.729**

Following on from the medium-term forecasts in table 2 above, the long-term liability benchmark assumes capital expenditure funded by borrowing of £7.6m a year, minimum revenue provision on new capital expenditure based on a 25 year asset life and reserves levels remaining at £13m. This is shown in the chart below together with the maturity profile of the Authority's existing borrowing:



The liability benchmark is a new treasury management prudential indicator in the 2021 edition of the CIPFA Treasury Management Code. The liability benchmark indicator has to be included for the first time in the 2023/24 Treasury Management Strategy.

Unlike other indicators, the liability benchmark is to be shown graphically for a minimum of ten years. It consists of four lines – the loans capital financing requirement (LCFR), the net loans requirement (NLR) and the liability benchmark itself (LB) plus a line for actual borrowing.

The concept is that the chart allows a comparison of current borrowing against the need to borrow. Where the LB exceeds actual loans held, the PCC can take long-term borrowing.

The LCFR can be described as the maximum permitted level of borrowing (effectively the Capital Financing Requirement). But borrowing up to the LCFR will usually mean high levels of investments, exposing West Mercia Police to credit, price and interest rate risks.

The NLR is the minimum possible level of borrowing, at which investments would be zero. This would expose West Mercia Police to the liquidity risk of being unable to make payments when due. Actual debt levels below this line would indicate “internal borrowing”.

The LB is then the optimal point between the two, where an appropriate balance of risks can be struck between these two extremes.

For the PCC for West Mercia, the chart shows the Capital Financing Requirement (blue line) remaining stable over time – This is because in the long run, the Minimum Revenue Provision Charges are expected to be roughly the same as our CFR. The level of actual debt (green line) decreases over time as existing loans mature however remain at £18m as West Mercia have long term loans that do not mature until 2048. The gap between the blue line (CFR) and the green line demonstrates the level of internal borrowing as set out in Table 4.2. The actual borrowing shown on the green line does not take account of the projected future borrowing shown in the table in 2.5, it is only plots the maturity of the current borrowing.

The Net Loans Requirement (grey line) takes into account usable reserves and working capital (Creditors minus Debtors) but assumes investments are zero. The Liability Benchmark assumes that investments will be maintained at around £4.8m. Therefore, the difference between the LB and the actual borrowing is the suggested ideal level of new borrowing that could be required over the period of the chart, taking into account levels of usable reserves, working capital, and investments.

1.11 Principle Banking Arrangements

The Commissioner holds fairly simply banking arrangements in that there are only 2 banks that West Mercia hold money with.

HSBC is the main bank account held by the Commissioner from which all Council Tax Precepts and grants are received, and payments are made. The Commissioner has placed limits on the amount of money held with a single bank to ensure security of deposits (see other counter party investments 7.9 below). A limit of £10m has been set as the maximum amount that can be held in our principal bank account with an institution that has a minimal credit rating of A- or equivalent.

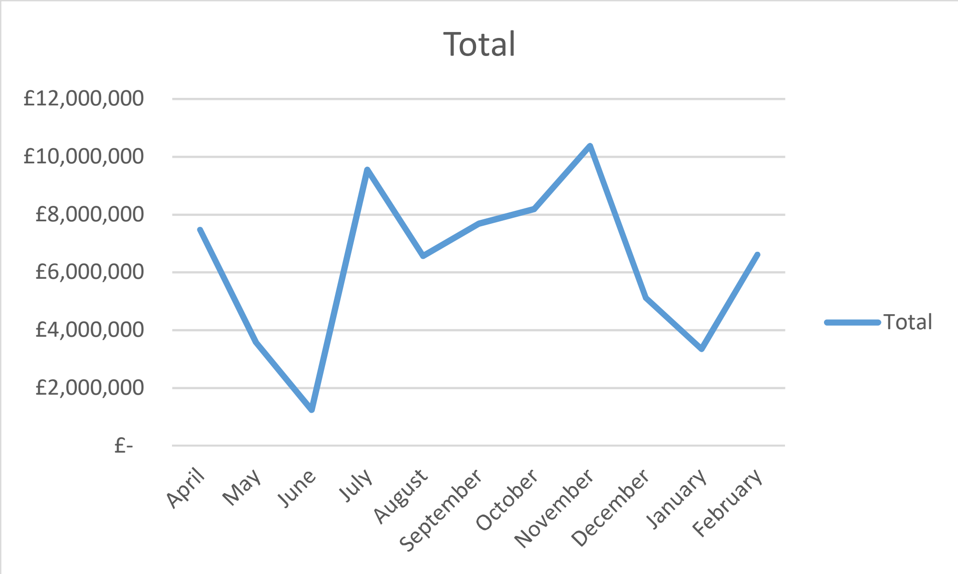
This limit has been set to balance the risk of security of resource against ensuring there is enough liquidity available to meet the liabilities that West Mercia holds on a daily basis. A review of expenditure commitments has identified that maintaining a balance of circa £5m is required. To provide headroom for receiving large funding income and flexibility to hold balances over short time periods to meet known future outgoings the overall limit has been set at £10m. It is not expected that balances will be routinely held at this maximum level.

As the resources held in the principal bank account are liquid, they can be transferred daily to other deposit facilities such as the DMO. If the credit rating falls below A- then the maximum amount that can be held in the account reduces to £1m. In the unlikely event that this occurs then we would ensure that this is maintained, although it is then also recognised that it would incur regular transaction costs. A review of banking arrangements would be undertaken and an assessment of whether to movie to an alternative supplier for our principal bank account would be made.

A second bank account with Santander which is primarily used for investment return on short term cash surpluses. The limit on this account is in line the counter party investment limits set out in this report.

1.12 Financial Assets held

West Mercia Police generally have surplus cash flow in the very short-term as council tax precepts and the police grant are received at the start of the month but are generally not fully spent until salaries are due at the end of the month. This creates a short term cash flow surplus for circa 3 weeks. This money can be invested to spread the risk of too much money being with a single bank and to generate a small return. West Mercia Police do not have long term cash surpluses as the capital programme is partially funded by internal borrowing, therefore reducing the cost of the capital programme to West Mercia.



The above table shows the average cash balances held in our bank accounts throughout 2022/23 (until 28th February 2023) that is available to invest at a point in time. It is important when looking at cash surpluses that West Mercia Police ensures that it has sufficient funds to cover any unexpected payments, with £2m being the minimum level of cash on hand we need to cover this situation with a working daily level of circa £5m to ensure availability of liquidity.

A local authority's power to invest Financial Assets is outlined in section 12 of the Local Government act 2003. It states that investment can be made:-

a) For any purpose relevant to its functions under any enactment, or
b) For the purpose of the prudent management of its financial affairs

Essentially an investment can be made if it assists you with your functions (policing) or for cash flow and treasury management reasons.

A PCC is required by law to have regard to the CIPFA Treasury Management and Prudential Codes. These now prohibit borrowing to invest primarily for financial return, but the power remains that a PCC can make loan for service-related reasons. For example, to make a loan to a charity that might help with crime reduction. The PCC is required ensure that when making decisions on providing a loan to a third party that is should be proportionate and that it considers the risk to the financial stability of the organisation that there could be a default on the loan.

Regulations also exist in looking to make loans

- If making loans to the general public or acting like a bank there are, in some circumstances, requirements to be regulated by the Financial Conduct Authority and potentially other regulators as well.
- If you are making loans to businesses, there is a requirement to make these at a fair market rate of interest so you are not seen to be giving them an unfair subsidy (commonly referred to as 'State Aid Rules').

The PCC strategy is that loans will prioritise liquidity and security in its approach to utilising Financial Assets. Therefore making short term deposits in banking institutions which have strong credit ratings.

2 Borrowing Strategy

The Commissioner 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 the Commissioner's reserves, balances and cash flow has been used as a temporary measure.

The Commissioner required £10m of borrowing in December 2022 to meet expenditure on the capital programme and to replace £5m of borrowing which had matured.

Due to a favourable cash flow position and slippage on the capital programme no additional PWLB borrowing will be required during 2022/23. Additional long term borrowing will be required in 2023/24 however in order to fund several large capital projects that are ongoing, including the investment in Digital Services Transformation, building of a joint Police and Fire station in Redditch and a new Firearms range.

As at 31st March 2023 estimated internal borrowing will be £26.8m. Against this background and the risks within the economic forecast, caution will be adopted with the 2023/24 treasury operations. The Treasury Team will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances. Any decisions will be reported to the Commissioner at the earliest available opportunity.

West Mercia currently holds £44.1 million of loans (with maturities of £0.0m prior to year-end). The table in 2.5 shows that there is a potential long-term borrowing requirement for 2023/24 of £32.1m, dependant on the progress of the capital programme. The Commissioner may however borrow to pre-fund future years' requirements and meet temporary cash flow deficits (and also to "externalise" current internal borrowing), providing this does not exceed the authorised limit for borrowing of £105m.

The Commissioner's chief objective when borrowing money will always be to strike an appropriately low risk balance between securing low interest costs and achieving certainty of those costs over the period for which funds are required. The flexibility to renegotiate loans should the Commissioner's long-term plans change is a secondary objective.

Given the significant cuts to public expenditure and in particular to local government funding, the Commissioner's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio.

With short-term interest rates currently lower than long-term rates, it is likely to be more cost effective to borrow short-term loans. By doing so, the Commissioner is able to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk. The benefits of internal and/or short-term borrowing will be monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing rates are forecast to rise modestly.

Arlingclose will assist the Commissioner with this ‘cost of carry’ and breakeven analysis. Its output may determine whether the Commissioner borrows additional sums at long-term fixed rates in 2023/24 with a view to keeping future interest costs low, even if this causes additional cost in the short-term.

The Commissioner’s debt portfolio has a spread of different maturity dates and structures for its loans.

The Commissioner has previously raised all long-term borrowing from the PWLB but the Commissioner will also consider long-term loans from other sources including banks, pensions and local authorities, in order to lower interest costs and reduce over-reliance on one source of funding in line with the CIPFA Code.

Alternatively, the Commissioner may arrange forward starting loans during 2023/24, where the interest rate is fixed in advance, but the cash is received in later years. This would enable certainty of cost to be achieved without suffering a cost of carry in the intervening period.

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

2.1 Sources of borrowing:

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

- HM Treasury’s PWLB Lending Facility and any successor body;
- any institution approved for investments (see below);
- any other bank or building society authorised to operate in the UK;
- any other UK public sector body;
- UK public and private sector pension funds (except Worcestershire County Council and Worcestershire County Council Pension Fund)

2.2 Other sources of debt finance:

In addition, capital finance may be raised by the following methods that are not borrowing, but may be classed as other debt liabilities:

- Leasing
- Hire Purchase
- Sale and Leaseback

The Commissioner has previously raised all of his long-term borrowing from the PWLB but continues to investigate other sources of finance, such as local authority loans and bank loans that may be available at more favourable rates.

2.3 Municipal Bonds Agency:

UK Municipal Bonds Agency plc was established in 2014 by the Local Government Association as an alternative to the PWLB. It issues bonds on the capital markets and lend the proceeds to local authorities. This is a more complicated source of finance than the PWLB for two reasons: borrowing authorities will be required to provide bond investors with a guarantee to refund their investment in the event that the agency is unable to for any reason; and there will be a lead time of several months between committing to borrow and knowing the interest rate payable. Any decision to borrow from the Agency will therefore be the subject of a separate report to the PCC.

2.4 Policy on Borrowing

In view of the above, the Commissioner's borrowing strategy will consider the following:

- The cheapest borrowing will be internal borrowing by running down cash balances, however this is unlikely to be an option for West Mercia during 2023/24 due to the low level of cash balances currently held and forecast for the forthcoming year;
- Where available, long-term fixed rate market loans at rates below PWLB rates for the equivalent maturity period. This would also maintain an appropriate balance between PWLB and market debt in the debt portfolio;
- PWLB borrowing across various maturity dates, usually annuity on EIP loans, depending on prevailing rates. This offers a range of options for new borrowing and will spread debt maturities in the debt portfolio.

In addition, it is important to note that Commissioner will seek to minimise his future borrowings by using revenue budget under spends to defray borrowing where this is feasible and prudent.

In normal circumstances, the main sensitivities of the forecast are likely to be the two scenarios noted below. The Treasurer, in conjunction with the Director of Commercial Services and the treasury advisors, will continually monitor both the prevailing interest rates and the market forecasts, adopting the following responses to a change of sentiment:

- If it were 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 the 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 were felt that there was a significant risk of a much sharper rise in long and short term rates than that currently forecast, perhaps arising from a greater than expected increase in world economic activity or a sudden increase in inflation risks, then the portfolio position will be reappraised with the likely action that fixed rate funding will be drawn whilst interest rates were still relatively cheap.

2.5 Policy on borrowing in advance of need

The CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code) underpins the system of capital finance, and a new edition of the Prudential Code was published in December 2021. The Code continues to include the principal that an authority must not borrow to invest primarily for financial return, apply with immediate effect.

The Commissioner will not borrow more than or in advance of his needs purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be considered carefully to ensure value for money can be demonstrated and that the Commissioner can ensure the security of such funds.

In determining whether borrowing will be undertaken in advance of need, the Commissioner will:

- Ensure that there is a clear link between the capital programme and maturity profile of the existing debt portfolio which supports the need to take funding in advance of need;
- ensure the ongoing revenue liabilities created, and the implications for the future plans and budgets have been considered;
- evaluate the economic and market factors that might influence the manner and timing of any decision to borrow;
- consider the merits and demerits of alternative forms of funding;
- consider the alternative interest rate bases available, the most appropriate periods to fund and repayment profiles to use;
- consider the impact of borrowing in advance of need temporarily (until required to finance capital expenditure) increasing investment cash balances and the consequent increase in exposure to counterparty risk, and other risks, and the level of such risks given the controls in place to minimise them.

2.6 Debt Rescheduling

The PWLB allows authorities to repay loans before maturity and either pay a premium or receive a discount according to a set formula based on current interest rates. Other lenders may also be prepared to negotiate premature redemption terms. The Commissioner may take advantage of this and replace some loans with new loans, or repay loans without replacement, where this is expected to lead to an overall cost saving or a reduction in risk. The recent rise in interest rates means that more favourable debt rescheduling opportunities should arise than in previous years.

The reason for any rescheduling to take place will include:

- the generation of cash savings and discounted cash flow savings;
- helping to fulfil the strategy outlined in Section 5 above, and
- enhancing the balance of the portfolio (amending the maturity profile and / or the balance of volatility)

3. Annual Investment Strategy

3.1 Investment Policy

The CIPFA requires the Commissioner to invest his funds prudently, and to have regard to the security and liquidity of their investments before seeking the highest rate of return, or yield. The Commissioner's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income. Where balances are expected to be invested for more than one year, the Commissioner will aim to achieve a total return that is equal or higher than the prevailing rate of inflation, in order to maintain the spending power of the sum invested.

The Commissioner's investment priorities are the security of capital and the liquidity of investments.

The Commissioner will also aim to achieve the optimum return on his investments, commensurate with proper levels of security and liquidity. The risk appetite of the Commissioner is extremely low in order to give overriding and absolute priority to the security of his investments.

In accordance with the above, and in order to minimise the risk to investments, the Commissioner has stipulated below the minimum acceptable credit quality of counterparties for inclusion on the lending list. The creditworthiness methodology used to create the counterparty list takes account of the ratings and watches published by all three ratings agencies, with a full understanding of what the ratings represent. Using information from Arlingclose, service banks' ratings are monitored on a real time basis with knowledge of any changes notified electronically as the agencies notify modifications.

Furthermore, the Commissioners' officers recognise 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 the institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To this end the Commissioners' officers will engage with the advisors, Arlingclose, to monitor market pricing 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.

Negative interest rates. The COVID-19 pandemic increased the risk that the Bank of England would set its Bank Rate at or below zero, although until the recent rises in Bank Rate, the lowest rate set was 0.1%. However, at various times during the last 12 months, this resulted in negative interest rates on low risk, short-term investment options with the UK DMO. Since investments cannot pay negative income, negative rates will be applied by reducing the value of investments. In this event, security will be measured as receiving the contractually agreed amount at maturity, even though this may be less than the amount originally invested. Given the increasing risk and very low returns from short term unsecured bank investments, the Commissioner will aim to diversify further and explore the opportunities for using additional short term bank and building society deposit accounts and/or Money Market Funds.

ESG policy: Environmental, social and governance (ESG) considerations are increasingly a factor in global investors' decision making, but the framework for evaluating investment opportunities is still developing. This strategy does not currently include ESG scoring or other real-time ESG criteria at an individual investment level. When investing in banks and funds, the Commissioner will prioritise banks that are signatories to the UN Principles for Responsible Banking and funds operated by managers that are signatories to the UN Principles for Responsible Investment, the Net Zero Asset Managers Alliance and/or the UK Stewardship Code

The Commissioner may invest its surplus funds with any of the counterparty types in the Table below, subject to the cash limits (per counterparty) and the time limits shown.

3.2 Approved Investment Counterparts and Limits.

Approved Counterparty Limits

Counterparties with a credit rating

Credit Rating	Banks & Building Societies Unsecured and Secured	Government (Incl. Local Authorities)	Registered Providers (Housing Associations)
UK Govt.	N/A	£ Unlimited 50 years	N/A
AAA, AA+, AA, AA-	£3m 3 Years	£3m 3 Years	£3m 3 Years
A+	£3m 2 Years	£3m 2 Years	£3m 2 Years
A	£3m 13 Months	£3m 2 Years	£3m 2 Years
A-	£3m 6 Months	£3m 2 Years	£3m 2 Years

Other Counterparty investments

UK Building Societies without Credit Ratings	N/A	N/A	N/A
UK Local Authorities (and PCCs) without credit ratings	N/A	£10m 3 Years	N/A
Money Market Funds	£2m Per Fund	N/A	N/A

Current Account Bank (HSBC) if the credit rating is A- or above	£10m (1 month) £5m (1 year)	N/A	N/A
Current Account Bank (HSBC) if it fails to meet the above criteria	£1m Next Working Day	N/A	N/A

This table must be read in conjunction with the notes below.

a) Credit rating: Investment limits are set by reference to the lowest published long-term credit rating from a selection of external rating agencies. Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used. However, investment decisions are never made solely based on credit ratings, and all other relevant factors including external advice will be taken into account.

b) Banks unsecured: Accounts, deposits, certificates of deposit and senior unsecured bonds with banks and building societies, other than multilateral development banks. These investments are subject to the risk of credit loss via a bail-in should the regulator determine that the bank is failing or likely to fail. See below for arrangements relating to operational bank accounts.

c) Banks secured: Covered bonds, reverse repurchase agreements and other collateralised arrangements with banks and building societies. These investments are secured on the bank's assets, which limits the potential losses in the unlikely event of insolvency, and means that they are exempt from bail-in. Where there is no investment specific credit rating, but the collateral upon which the investment is secured has a credit rating, the higher of the collateral credit rating and the counterparty credit rating will be used to determine cash and time limits. The combined secured and unsecured investments in any one bank will not exceed the cash limit for secured investments.

d) Government: Loans, bonds and bills issued or guaranteed by national governments, regional and local authorities and multilateral development banks. These investments are not subject to bail-in, and there is generally a lower risk of insolvency, although they are not zero risk. Investments with the UK Central Government are deemed to be zero credit risk due to its ability to create additional currency and therefore may be made in unlimited amounts for up to 50 years.

f) Registered providers: Loans and bonds issued by, guaranteed by or secured on the assets of registered providers of social housing and registered social landlords, formerly known as housing associations. These bodies are regulated by the Regulator of Social Housing (in England), the Scottish Housing Regulator, the Welsh Government and the Department for Communities (in Northern Ireland). As providers of public services, they retain the likelihood of receiving government support if needed.

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

h)   Operational bank accounts: The Commissioner may incur operational exposures, for example though current accounts, collection accounts and merchant acquiring services, to any UK bank with credit ratings no lower than BBB- and with assets greater than £25 billion. These are not classed as investments, but are still subject to the risk of a bank bail-in, and balances will therefore be kept below £10m per bank. The Bank of England has stated that in the event of failure, banks with assets greater than £25 billion are more likely to be bailed-in than made insolvent, increasing the chance of the Force maintaining operational continuity.

West Mercia is expected to have £5.0 m invested funds as at 31 March 2023, representing income received in advance of expenditure plus balances and reserves held. In the past 12 months, West Mercia's investment balance ranged between zero and £32 million; it is likely that the maximum cash available to invest in 2023/24 will be £55m in July when the Pensions Grant is received (and any short-term temporary borrowing will be repaid). The average investment in 2022/23 lasted 17 days, with the minimum being 2 days and the maximum being 68 days. Cash balances will be relatively low throughout the 2023/24 year and temporary borrowing will be required at certain times of the year to address cash flow deficits.

Risk Assessment and Credit Ratings:

Credit ratings are obtained and monitored by the Commissioners treasury advisers, who will notify changes in ratings as they occur. Where an entity has its credit rating downgraded so that it fails to meet the approved investment criteria then:

- no new investments will be made,
- any existing investments that can be recalled or sold at no cost will be, and
- full consideration will be given to the recall or sale of all other existing investments with the affected counterparty.

Where a credit rating agency announces that a credit rating is on review for possible downgrade (also known as "rating watch negative") so that it may fall below the approved rating criteria, then only investments that can be withdrawn on the next working day will be made with that organisation until the outcome of the review is announced. This policy will not apply to negative outlooks, which indicate a long-term direction of travel rather than an imminent change of rating.

Other information on the security of investments: The Commissioner understands that credit ratings are good, but not perfect, predictors of investment default. Full regard will therefore be given to other available information on the credit quality of the organisations in which it invests, including credit default swap prices, financial statements, information on potential government support, reports in the quality financial press and analysis and advice from the Commissioner's treasury management adviser. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may otherwise meet the above criteria.

When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008 and 2020, this is not generally reflected in credit ratings, but can be seen in other market measures. In these circumstances, the Commissioner will restrict its investments to those organisations of higher credit quality and reduce the maximum duration of its investments to maintain the required level of security. The extent of these restrictions will be in line with prevailing financial market conditions. If these restrictions mean that insufficient commercial organisations of high credit quality are available to invest the Commissioners cash balances, then the surplus will be deposited with the UK Government via the Debt Management Office or invested in government treasury bills for example, or with other local authorities. This will cause investment returns to fall, but will protect the principal sum invested.

3.3 Investment Limits

The Commissioner for West Mercia's revenue reserves available to cover investment losses are estimated to be £14.7m on 31st March 2023. In order that no more than 20% of available reserves will be put at risk in the case of a single default the maximum that will be lent to any one organisation other than the UK government and the Commissioner's bankers will be £3m.

A group of banks under the same ownership will be treated as a single organisation for limit purposes.

Limits will also be placed on the total investment in any individual sector in or fund managers. The total exposure in each sector is to be limited to:-

Investment sector	**Cash Limit**
UK Central Government	Unlimited
Any other single organisation than the UK Central Government	£3m
Any group of organisations under the same ownership	£3m per group
Registered Providers (Housing Associations)	£5m
Unsecured Investments with Building Societies	£5m
Money Market Funds	£5m
Foreign Countries	£2m
Force Banking Provider HSBC	£10m

3.4 Liquidity Management

The Commissioner’s cash flow forecasts are updated regularly throughout the year to determine the maximum period for with funds may prudently be committed. Current forecasts are compiled on a prudent basis to minimise the risk of the Commissioner being force to borrow on unfavourable terms to meet their financial commitments. Limits on long-term investments are set by reference to the Commissioner’s medium term financial plan and cash flow forecast.

3.5 Treasury Management Prudential Indicators

The Commissioner measures and manages his exposure to treasury management risks using Treasury Management indicators governing upper limits for fixed and variable rate exposure.

3.6 Security

The Commissioner has adopted a voluntary measure of his exposure to credit risk by monitoring the value weighted average credit rating / credit score of their investment portfolios.

	Target
Portfolio average credit rating for West Mercia	A-

3.7 Liquidity

The Commissioner has adopted a voluntary measure of his exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments within a rolling three month period without additional borrowing.

	Target
Total Cash Available within 3 months for West Mercia	£20m

3.8 Interest Rate Exposures

This indicator is set to control the Commissioner’s exposure to interest rate risk. All borrowing is at fixed interest rates therefore a 1% increase or decrease would only affect new borrowings. Investments are also made at fixed rates but for much shorter periods so a 1% change in interest rates will have more of an effect on returns from investments. With the Bank of England Base Rate being relatively high at 4.0%, interest receivable is expected to also be high in 2023/24 compared to previous years. The one year revenue impact of a 1% rise or fall in interest rates based on the figures showing in table 1.9 will be:

	Max Impact Per £5m of investment:
Investments	
One-year revenue impact of a 1% rise in interest rates	(£50,000)
One-year revenue impact of a 1% fall in interest rates	£50,000
	Max Impact Per £66.2m of Borrowing:
Borrowing	
One-year revenue impact of a 1% rise in interest rates	£662,000
One-year revenue impact of a 1% fall in interest rates	(£662,000)

3.9 Maturity Structure of Borrowing

This indicator is set to control the Commissioner's exposure to refinancing risk. The upper and lower limits on the maturity of fixed rate borrowing will be:

	Upper	Lower
Under 12 Months	15%	0%
12 Months and within 24 Months	15%	0%
24 Months and within 5 Years	25%	15%
5 Years and within 10 Years	50%	25%
10 Years and above	100%	50%

Effectively the Commissioner is satisfied that all borrowing can be held at a fixed rate, irrespective of age profile.

Time periods start on the first day or each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment.

3.10 Principal Sums Invested for Periods Longer than 364 days

The purpose of this indicator is to control the Commissioner's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the long-term principal sum invested to final maturities beyond the period end will be:

West Mercia	2023/24	2024/25	2025/26
Limit on principal invested beyond year end	£5m	£5m	£5m

3.11 Other Items

The CIPFA Code requires the Authority to include the following in its treasury management strategy:

3.12 Policy on Use of Financial Derivatives:

In the absence of any explicit legal power to do so, the Commissioner will not use standalone financial derivatives (such as swaps, forwards, futures and options). Derivates embedded into loans and investments, including pooled funds and forward starting transactions, may be used, and the risks that they present will be managed in line with the overall treasury risk management strategy.

The Commissioner can make use of financial derivatives embedded into loans and investments both to reduce interest rate risk (e.g. interest rate collars and forward deals) and to reduce costs or increase income at the expense of greater risk (e.g. LOBO loans and callable deposits). The general power of competence in Section 1 of the Localism Act 2011 removes much of the uncertainty over local authorities' use of standalone financial derivatives (i.e. those that are not embedded into a loan or investment).

3.13 Investment Training

The needs of the Commissioner's treasury management staff for training in investment management are assessed annually as part of the staff appraisal process, and additionally when the responsibilities of individual members of staff change. Staff regularly attend training courses, seminars and conferences provided by Arlingclose and CIPFA. Relevant staff are also encouraged to study professional qualifications from CIPFA, the Association of Corporate Treasurers and other appropriate organisations.

Investment Advisers: The Commissioner has appointed Arlingclose Limited as treasury management advisers and receives specific advice on investment, debt and capital finance issues.

3.14 Investment of Money Borrowed in Advance of Need

The Commissioner may, from time to time, borrow in advance of need, where this is expected to provide the best long term value for money. Since amounts borrowed will be invested until spent, the Commissioner is aware that it will be exposed to the risk of loss of the borrowed sums, and the risk that investment and borrowing interest rates may change in the intervening period. These risks will be managed as part of the Commissioner's overall management of its treasury risks.

The total amount borrowed will not exceed the authorised borrowing limit of £105m. The maximum period between borrowing and expenditure is expected to be two years, although the Commissioner is not required to link particular loans with particular items of expenditure.

3.15 Financial Implications

The budget for investment income in 2023/24 is £100k, based on an average investment portfolio of £3.5 million at an interest rate of 3.00%. The budget for debt interest paid in 2023/24 is £1.46m, based on an average debt portfolio of £54.0m at an average interest rate of 2.71%.

If actual levels of investments and borrowing, and actual interest rates differ from those forecast, performance against budget will be correspondingly different. Due to the increases in Bank Rate it is likely that interest receivable will be higher than budget (investments made at variable rates); rates on new borrowing are higher than recent years however the majority of our existing borrowing is at fixed rates so there will be less impact on interest payable.

Although new borrowing could be in the region of £32m in 2023/24, depending on the progress of the capital programme, it is forecast that any new borrowing wouldn't be required until the final quarter of 2023/24, hence the average debt portfolio figure being lower than the forecasted borrowing as at 31 arch 2024 set out in the table in 4.2.

3.16 Other Options Considered

The CIPFA Code does not prescribe any particular treasury management strategy for local authorities to adopt. The Treasurer having consulted the Joint Audit and Standards Committee believes that the above strategy represents an appropriate balance between risk management and cost effectiveness. Some alternative strategies, with their financial and risk management implications, are listed below.

Alternative	Impact on Income and Expenditure	Impact on Risk Management
Invest in a narrower range of counterparties and / or for shorter times.	Interest income will be lower.	Lower chance of losses from credit related defaults, but any such losses may be greater.

Invest in a wider range of counterparties and / or for longer times.	Interest income will be higher.	Increased risk of losses from credit related defaults, but any such losses may be smaller.
Borrow additional sums at long-term fixed interest rates.	Debt interest costs will rise; this is unlikely to be offset by higher investment income.	Higher investment balance leading to a higher impact in the event of a default, however long-term interest costs may be more certain.
Borrow short-term or variable loans instead of long-term fixed rates.	Debt interest costs will initially be lower.	Increases in debt interest costs will be broadly offset by rising investment income in the medium term, but long term costs may be less certain.
Reduce level of borrowing	Saving on debt interest is likely to exceed lost investment income.	Reduced investment balance leading to a lower impact in the event of a default; however long-term interest costs may be less certain.

APPENDIX A

POLICE AND CRIME COMMISSIONER FOR WEST MERCIA

Prudential Indicators and MRP Statement 2023/24

Prudential Indicators 2023/24

The Local Government Act 2003 requires the Authority to have regard to the Chartered Institute of Public Finance and Accountancy's *Prudential Code for Capital Finance in Local Authorities* (the Prudential Code) when determining how much money it can afford to borrow. The objectives of the Prudential Code are to ensure, within a clear framework, that the capital investment plans of Police and Crime Commissioners (PCCs) are affordable, prudent and sustainable, and that treasury management decisions are taken in accordance with good professional practice. To demonstrate that the PCC has fulfilled these objectives, the Prudential Code sets out the following indicators that must be set and monitored each year.

Estimates of Capital Expenditure: The PCC's planned capital expenditure and financing may be summarised as follows:

Capital Expenditure and Financing	2022/23 Latest Forecast £m	2023/24 Estimate £m	2024/25 Estimate £m	2025/26 Estimate £m
Total Expenditure	**16.8**	**28.6**	**19.4**	**9.4**
Capital Receipts	0.5	0.5	0.5	0.5
Government & Specific Grants	0.0	0.0	0.8	0.0
Reserves	0.0	0.0	0.0	0.0
Revenue	1.4	1.0	1.1	1.2
Borrowing	14.9	27.1	17.0	7.7
Total Financing	**16.8**	**28.6**	**19.4**	**9.4**

Estimates of Capital Financing Requirement: The Capital Financing Requirement (CFR) measures the Commissioners underlying need to borrow for a capital purpose.

Capital Financing Requirement	31.03.23 Revised £m	31.03.24 Estimate £m	31.03.25 Estimate £m	31.03.26 Estimate £m
Total CFR	**70.761**	**92.265**	**101.449**	**100.401**

The CFR is forecast to rise by £29.7m over the next three years as capital expenditure financed by debt outweighs resources put aside for debt repayment.

Total debt is expected to remain below the CFR during the forecast period.

Increases in the CFR and borrowing are undertaken solely for purposes directly and primarily related to the functions of the authority. Where any financial returns are related to the financial viability of the project in question, they are incidental to its primary purpose.

Operational Boundary for External Debt: The operational boundary is based on the PCC's estimate of most likely (i.e. prudent but not worst case) scenario for external debt. It links directly to the PCC's estimates of capital expenditure, the CFR and cash flow requirements, and is a key management tool for in-year monitoring.

Operational Boundary	2022/23 Revised £m	2023/24 Estimate £m	2024/25 Estimate £m	2025/26 Estimate £m
Total Debt	**95.0**	**110.0**	**110.0**	**110.0**

Authorised Limit for External Debt: The authorised limit is the affordable borrowing limit determined in compliance with the Local Government Act 2003. It is the maximum amount of debt that the Commissioners can legally owe. The authorised limit provides headroom over and above the operational boundary for unusual cash movements.

Authorised Limit	2021/22 Revised £m	2022/23 Estimate £m	2023/24 Estimate £m	2024/25 Estimate £m
Total Debt	**105.0**	**120.0**	**120.0**	**120.0**

Ratio of Financing Costs to Net Revenue Stream: This is an indicator of affordability and highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet financing costs, net of investment income.

Ratio of Financing Costs to Net Revenue Stream	2022/23 Revised %	2023/24 Estimate %	2024/25 Estimate %	2025/26 Estimate %
General Fund	1.76	2.45	3.58	4.03

Annual Minimum Revenue Provision Statement 2023/24

Where the PCC finances capital expenditure by debt, he must put aside resources to repay that debt in later years. The amount charged to the revenue budget for the repayment of debt is known as Minimum Revenue Provision (MRP), although there has been no statutory minimum since 2008. The Local Government Act 2003 requires the PCC to have regard to the former Ministry of Housing, Communities and Local Government's *Guidance on Minimum Revenue Provision* (the MHCLG Guidance) most recently issued in 2018.

The broad aim of the MHCLG Guidance is to ensure that capital expenditure is financed over a period that is either reasonably commensurate with that over which the capital expenditure provides benefits, or, in the case of borrowing supported by Government Revenue Support Grant, reasonably commensurate with the period implicit in the determination of that grant.

The MHCLG Guidance requires the PCC to approve an Annual MRP Statement each year and recommends a number of options for calculating a prudent amount of MRP. The following statement incorporates options recommended in the Guidance:

For capital expenditure incurred before 1st April 2008, MRP will be determined in accordance with the former regulations that applied on 31st March 2008. MRP has been calculated on a straight-line basis over a 40 year period.

For unsupported capital expenditure incurred after 31st March 2008, MRP will be determined by charging the expenditure over the period over which the capital expenditure provides a benefit to the PCC (based on the expected useful life of the relevant asset) using the annuity method, starting in the year after the asset becomes operational.

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

Based on the PCC's estimate of its Capital Financing Requirement on 31st March 2023 at the time of setting the budget, the budget for MRP has been set as follows:

	31.03.2023 Estimated CFR £m	**2023/24 Estimated MRP**

		£m
Capital expenditure before 01.04.2008	0.011	0.000
Unsupported capital expenditure after 31.03.2008	70,935	5.767
Total	**70.946**	**5.767**

APPENDIX B

The Treasury Management Role of the S151 (Responsible) Officer

- Recommending clauses, treasury management policy / practices for approval, reviewing the same regularly, and monitoring compliance.

- Reviewing the list of approved counterparties in accordance with recommendations from appointed treasury advisers (currently Arlingclose).

- 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.

Appendix C –

Arlingclose Economic & Interest Rate Forecast December 2022

Underlying assumptions:

- The influence of the mini-budget on rates and yields continues to wane following the more responsible approach shown by the new incumbents of Downing Street.

- Volatility in global markets continues, however, as investors seek the extent to which central banks are willing to tighten policy, as evidence of recessionary conditions builds. Investors have been more willing to price in the downturn in growth, easing financial conditions, to the displeasure of policymakers. This raises the risk that central banks will incur a policy error by tightening too much.

- The UK economy is already experiencing recessionary conditions and recent GDP and PMI data suggests the economy entered a technical recession in Q3 2022. The resilience shown by the economy has been surprising, despite the downturn in business activity and household spending. Lower demand should bear down on business pricing power – recent data suggests the UK has passed peak inflation.

- The lagged effect of the sharp tightening of monetary policy, and the lingering effects of the mini-budget on the housing market, widespread strike action, alongside high inflation, will continue to put pressure on household disposable income and wealth. The short- to medium-term outlook for the UK economy remains bleak.

- Demand for labour appears to be ebbing, but not quickly enough in the official data for most MPC policymakers. The labour market remains the bright spot in the economy and persisting employment strength may support activity, although there is a feeling of borrowed time. The MPC focus is on nominal wage growth, despite the huge real term pay cuts being experienced by the vast majority. Bank Rate will remain relatively high(er) until both inflation and wage growth declines.

- Global bond yields remain volatile as investors price in recessions even as central bankers push back on expectations for rate cuts in 2023. The US labour market remains tight and the Fed wants to see persistently higher policy rates, but the lagged effects of past hikes will depress activity more significantly to test the Fed's resolve.

- While the BoE appears to be somewhat more dovish given the weak outlook for the UK economy, the ECB seems to harbour (worryingly) few doubts about the short term direction of policy. Gilt yields will be broadly supported by both significant new bond supply and global rates expectations due to hawkish central bankers, offsetting the effects of declining inflation and growth.

Forecast:

- The MPC raised Bank Rate by 50bps to 3.5% in December as expected, with signs that some members believe that 3% is restrictive enough. However, a majority of members think further increases in Bank Rate might be required. Arlingclose continues to expect Bank Rate to peak at 4.25%, with further 25bps rises February, March and May 2023.

• The MPC will cut rates in the medium term to stimulate a stuttering UK economy, but will be reluctant to do so until wage growth eases. We see rate cuts in the first half of 2024.

• Arlingclose expects gilt yields to remain broadly steady over the medium term, although with continued volatility across shorter time periods.

• Gilt yields face pressures to both sides from hawkish US/EZ central bank policy on one hand to the weak global economic outlook on the other. BoE bond sales and high government borrowing will provide further underlying support for yields.

	Current	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25
Official Bank Rate													
Upside risk	0.00	0.50	0.75	1.00	1.00	1.00	1.25	1.50	1.75	1.50	1.25	1.25	1.25
Arlingclose Central Case	3.50	4.00	4.25	4.25	4.25	4.25	4.00	3.75	3.50	3.25	3.25	3.25	3.25
Downside risk	0.00	0.50	0.75	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.00	1.00
3-month money market rate													
Upside risk	0.00	0.50	0.75	1.00	1.00	1.00	1.25	1.50	1.75	1.50	1.25	1.25	1.25
Arlingclose Central Case	3.00	4.40	4.40	4.40	4.35	4.30	4.25	4.00	3.75	3.50	3.40	3.40	3.40
Downside risk	0.00	0.50	0.75	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.00	1.00
5yr gilt yield													
Upside risk	0.00	0.70	0.80	0.90	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Arlingclose Central Case	3.43	3.60	3.80	3.80	3.80	3.70	3.60	3.50	3.40	3.30	3.30	3.30	3.30
Downside risk	0.00	0.80	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
10yr gilt yield													
Upside risk	0.00	0.70	0.80	0.90	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Arlingclose Central Case	3.47	3.50	3.60	3.60	3.60	3.60	3.50	3.50	3.50	3.50	3.50	3.50	3.50
Downside risk	0.00	0.80	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
20yr gilt yield													
Upside risk	0.00	0.70	0.80	0.90	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Arlingclose Central Case	3.86	3.85	3.85	3.85	3.85	3.85	3.85	3.85	3.85	3.85	3.85	3.85	3.85
Downside risk	0.00	0.80	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
50yr gilt yield													
Upside risk	0.00	0.70	0.80	0.90	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Arlingclose Central Case	3.46	3.60	3.60	3.60	3.60	3.60	3.60	3.60	3.60	3.60	3.60	3.60	3.60
Downside risk	0.00	0.80	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00

PWLB Standard Rate (Maturity Loans) = Gilt yield + 1.00%

PWLB Certainty Rate (Maturity Loans) = Gilt yield + 0.80%

UKIB Rate (Maturity Loans) = Gilt yield + 0.60%