HUMBERSIDE
POLICE & CRIME
COMMISSIONER

TREASURY MANAGEMENT STRATEGY STATEMENT

2021/22

INTRODUCTION

Background

The Police and Crime Commissioner (PCC) 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 the PCC's low risk appetite, providing adequate liquidity initially before considering investment return.

The second main function of the treasury management service is the funding of the PCC's capital plans. These capital plans provide a guide to the borrowing need of the PCC, essentially the longer-term cash flow planning, to ensure that the PCC 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 occasion, when it is prudent and economic, any debt previously drawn may be restructured to meet a risk or cost objectives.

CIPFA defines treasury management as:

> *"The management of the local authority's borrowing, 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."*

PCC's are subject to the same requirements as Local Authority's in respect of treasury management.

Reporting requirements

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

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

- the capital plans (including prudential indicators);
- a minimum revenue provision (MRP) policy (how residual capital expenditure is charged to revenue over time);
- the treasury management strategy (how the investments and borrowings are to be organised) including treasury indicators; and
- an investment strategy (the parameters on how investments are to be managed).

A mid-year treasury management report – This will update the PCC with the progress of the capital position, amending prudential indicators as necessary, and whether any policies require revision.

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

Scrutiny

The above reports are required to be adequately scrutinised before being recommended to the PCC. This role is undertaken by the Joint Independent Audit Committee (JIAC).

Capital Strategy

In December 2017, CIPFA issued revised Prudential and Treasury Management Codes. As from 2019-20, all local authorities and PCCs are required to prepare an additional report, a Capital Strategy report, which is intended to provide the following:-

- a high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services;
- an overview of how the associated risk is managed;
- the implications for future financial sustainability.

The aim of this report is to ensure that the PCC fully understands the overall strategy, governance procedures and risk appetite. The Capital Strategy is set out at Appendix 8 of this report.

Treasury Management Strategy for 2021/22

The strategy for 2021/22 covers two main areas:

Capital issues

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

Treasury management issues

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

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

The CIPFA Code requires the responsible officer to ensure that the PCC with responsibility for treasury management receive adequate training in treasury management. This especially applies to Members of Joint Independent Audit Committee (JIAC) who are responsible for scrutiny. Training will be arranged as required.

Treasury management consultants

The PCC uses Link Asset Services, Treasury solutions as its external treasury management advisors.

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

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

THE CAPITAL PRUDENTIAL INDICATORS 2021/22 – 2024/25

The PCC's capital expenditure plans are the key driver of treasury management activity. The output of the capital expenditure plans is reflected in the prudential indicators, which are designed to assist the PCC's overview and confirm capital expenditure plans.

Capital expenditure – Indicator 1

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

Capital expenditure £m	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate
Total	**18.097**	**28.573**	**7.179**	**3.521**	**8.390**

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

Financing of capital expenditure £m	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate
Net financing need for the year	**17.761**	**28.386**	**7.179**	**3.521**	**8.390**

The PCC's borrowing need (the Capital Financing Requirement) – Indicator 2

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

The CFR does not increase indefinitely, as the minimum revenue provision (MRP) is a statutory annual revenue charge which broadly reduces the indebtedness in line with each assets life, and so charges the economic consumption of capital assets as they are used.

The PCC is asked to approve the CFR projections below:

£m	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate
Capital Financing Requirement					
Total CFR	**102.336**	**127.031**	**128.869**	**126.014**	**127.413**
CFR as a % of Budget Requirement	**51.49%**	**60.32%**	**58.92%**	**56.26%**	**55.63%**
Movement in CFR	**15.382**	**24.695**	**1.838**	**(2.855)**	**1.399**
Movement in CFR represented by					
Net financing need for the year (above)	17.761	28.386	7.179	3.521	8.390
Less MRP/VRP and other financing movements	(2.379)	(3.691)	(5.341)	(6.376)	(6.991)
Movement in CFR	**15.382**	**24.695**	**1.838**	**(2.855)**	**(1.399)**

This table shows CFR increasing to circa 60% of our Budget Requirement (BR) over the period 2021/22 to 2024/25, before beginning to fall.

*IFRS16 Leases comes into effect from 2021/22 (delayed for one year). The impact of this is yet to be established and will be reviewed throughout the year.

Core funds and expected investment balances – Indicator 3

The application of resources (capital receipts, reserves etc.) to either finance capital expenditure or other budget decisions to support the revenue budget will have an ongoing impact on investments unless resources are supplemented each year from new sources (asset sales etc.). Detailed below are estimates of the year-end balances for each resource and anticipated day-to-day cash flow balances.

Year End Resources £m	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate
Fund balances / reserves	16.900	13.500	14.600	13.600	10.700
Total core funds	**16.900**	**13.500**	**14.600**	**13.600**	**10.700**
Working capital*	**(10.000)**	**(10.000)**	**(10.000)**	**(10.000)**	**(10.000)**
(Under)/over borrowing	(35.443)	(20.635)	(11.780)	(7.179)	(1.515)
Expected investments	**(28.543)**	**(17.135)**	**(7.180)**	**(3.579)**	**(0.815)**

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

TREASURY MANAGEMENT PRUDENTIAL INDICATORS 2021/22 – 2024/25

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

Current portfolio position

The PCC's estimated treasury portfolio position at 31 March 2021, with forward projections are summarised below. The table shows the actual external debt (the treasury management operations), against the underlying capital borrowing need (the Capital Financing Requirement - CFR), highlighting any over or under borrowing.

£m	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate
External Debt					
Debt at 1 April	64.966	91.588	108.234	114.234	120.234
Expected change in Debt	26.622	16.646	6.000	6.000	6.000
Actual gross debt at 31 March	**91.588**	**108.234**	**114.234**	**120.234**	**126.234**
The Capital Financing Requirement	**102.336**	**127.031**	**128.869**	**126.014**	**127.413**
Under / (over) borrowing	**10.748**	**18.797**	**14.635**	**5.780**	**1.179**

Within the prudential indicators there are a number of key indicators to ensure that the PCC operates its activities within well-defined limits. One of these is that the PCC needs to ensure that its gross debt does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2021/22 and the following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue or speculative purposes.

The Chief Finance Officer & S.151 Officer reports that the PCC complied with this prudential indicator in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans, and the proposals in this budget report.

Treasury Indicators: limits to borrowing activity

The operational boundary – Indicator 4

This is the limit beyond which external debt is not normally expected to exceed. In most cases, this would be a similar figure to the CFR, but may be lower or higher depending on the levels of actual debt and the ability to fund under-borrowing by other cash resources.

Operational boundary £m	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate
Debt	150.000	150.000	150.000	150.000
Total	**150.000**	**150.000**	**150.000**	**150.000**

The authorised limit for external debt – Indicator 5

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

1. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003. The Government retains an option to control either the total of all PCCs' plans, or those of a specific PCC, although this power has not yet been exercised.

2. The PCC is asked to approve the following authorised limit:

Authorised limit £m	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate
Debt	180.000	180.000	180.000	180.000
Total	**180.000**	**180.000**	**180.000**	**180.000**

Prospects for interest rates

The PCC has appointed Link Group as its treasury advisor and part of their service is to assist the PCC to formulate a view on interest rates. Link provided the following forecasts on 11.8.20. However, following the conclusion of the review of PWLB margins over gilt yields on 25.11.20, all forecasts below have been reduced by 1%. These are forecasts for certainty rates, gilt yields plus 80bps:

Link Group Interest Rate View 9.11.20													
These Link forecasts have been amended for the reduction in PWLB margins by 1.0% from 26.11.20													
	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24
BANK RATE	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
3 month ave earnings	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
6 month ave earnings	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
12 month ave earnings	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20
5 yr PWLB	0.80	0.80	0.80	0.80	0.90	0.90	0.90	0.90	0.90	1.00	1.00	1.00	1.00
10 yr PWLB	1.10	1.10	1.10	1.10	1.20	1.20	1.20	1.20	1.20	1.30	1.30	1.30	1.30
25 yr PWLB	1.50	1.60	1.60	1.60	1.60	1.70	1.70	1.70	1.70	1.80	1.80	1.80	1.80
50 yr PWLB	1.30	1.40	1.40	1.40	1.40	1.50	1.50	1.50	1.50	1.60	1.60	1.60	1.60

Additional notes by Link on this forecast table: -

- *Please note that we have made a slight change to our interest rate forecasts table above for forecasts for 3, 6 and 12 months. Traditionally, we have used LIBID forecasts, with the rate calculated using market convention of 1/8th (0.125%) taken off the LIBOR figure. Given that all LIBOR rates up to 6m are currently running below 10bps, using that convention would give negative figures as forecasts for those periods. However, the liquidity premium that is still in evidence at the short end of the curve means that the rates actually being achieved by local authority investors are still modestly in positive territory. While there are differences between counterparty offer rates, our analysis would suggest that an average rate of around 10 bps is achievable for 3 months, 10bps for 6 months and 20 bps for 12 months.*
- *During 2021, Link will be continuing to look at market developments in this area and will monitor these with a view to communicating with clients when full financial market agreement is reached on how to replace LIBOR. This is likely to be an iteration of the overnight SONIA rate and the use of compounded rates and Overnight Index Swap (OIS) rates for forecasting purposes.*
- *We will maintain continuity by providing clients with LIBID investment benchmark rates on the current basis.*

The coronavirus outbreak has done huge economic damage to the UK and economies around the world. After the Bank of England took emergency action in March to cut Bank Rate to first 0.25%, and then to 0.10%, it left Bank Rate unchanged at its subsequent meetings to 16th December, although some forecasters had suggested that a cut into negative territory could happen. However, the Governor of the Bank of England has made it clear that he currently thinks that such a move would do more damage than good and that more quantitative easing is the favoured tool if further action becomes necessary. As shown in the forecast table above, no increase in Bank Rate is expected in the near-term as economic recovery is expected to be only gradual and, therefore, prolonged. These forecasts were based on an assumption that a Brexit trade deal would be agreed by 31.12.20: as this has now occurred, these forecasts do not need to be revised.

Gilt yields / PWLB rates

There was much speculation during the second half of 2019 that bond markets were in a bubble which was driving bond prices up and yields down to historically very low levels. The context for that was a heightened expectation that the US could have been heading for a recession in 2020. In addition, there were growing expectations of a downturn in world economic growth, especially due to fears around the impact of the trade war between the US and China, together with inflation generally at low levels in most countries and expected to remain subdued. Combined, these conditions were conducive to very low bond yields. While inflation targeting by the major central banks has been successful over the last thirty years in lowering inflation expectations, the real equilibrium rate for central rates has fallen considerably due to the high level of borrowing by consumers. This means that central banks do not need to raise rates as much now to have a major impact on consumer spending, inflation, etc. The consequence of this has been the gradual lowering of the overall level of interest rates and bond yields in financial markets over the last 30 years. Over the year prior to the coronavirus crisis, this has seen many bond yields up to 10 years turn negative in the Eurozone. In addition, there has, at times, been an inversion of bond yields in the US whereby 10 year yields have fallen below shorter term yields. In the past, this has been a precursor of a recession. The other side of this coin is that bond prices are elevated as investors would be expected to be moving out of riskier assets i.e. shares, in anticipation of a downturn in corporate earnings and so selling out of equities.

Gilt yields had therefore already been on a generally falling trend up until the coronavirus crisis hit western economies during March 2020. After gilt yields spiked up during the financial crisis in March, we have seen these yields fall sharply to unprecedented lows as investors panicked during March in selling shares in anticipation of impending recessions in western economies, and moved cash into safe haven assets i.e. government bonds. However, major western central banks took rapid action to deal with excessive stress in financial markets during March, and started massive quantitative easing purchases of government bonds: this also acted to put downward pressure on government bond yields at a time when there has been a huge and quick expansion of government expenditure financed by issuing government bonds. Such unprecedented levels of issuance in "normal" times would have caused bond yields to rise sharply. Gilt yields and PWLB rates have been at remarkably low rates so far during 2020/21.

As the interest forecast table for PWLB certainty rates above shows, there is expected to be little upward movement in PWLB rates over the next two years as it will take economies, including the UK, a prolonged period to recover all the momentum they have lost in the sharp recession caused during the coronavirus shut down period. From time to time, gilt yields, and therefore PWLB rates, can be subject to exceptional levels of volatility due to geo-political, sovereign debt crisis, emerging market developments and sharp changes in investor sentiment, (as shown on 9th November when the first results of a successful COVID-19 vaccine trial were announced). Such volatility could occur at any time during the forecast period.

Investment and borrowing rates

- **Investment returns** are likely to remain exceptionally low during 2021/22 with little increase in the following two years.

- **Borrowing interest rates** fell to historically very low rates as a result of the COVID crisis and the quantitative easing operations of the Bank of England: indeed, gilt yields up to 6 years were negative during most of the first half of 20/21. The policy of avoiding new borrowing by running down spare cash balances has served local authorities well over the last few years. The unexpected increase of 100 bps in PWLB rates on top of the then current margin over gilt yields of 80 bps in October 2019, required an initial major rethink of local authority treasury management strategy and risk management. However, in March 2020, the Government started a consultation process for reviewing the margins over gilt rates for PWLB borrowing for different types of local authority capital expenditure. It also introduced the following rates for borrowing for different types of capital expenditure: -

- **PWLB Standard Rate** is gilt plus 200 basis points (G+200bps)
- **PWLB Certainty Rate** is gilt plus 180 basis points (G+180bps)

- As a consequence of these increases in margins, many local authorities decided to refrain from PWLB borrowing unless it was for HRA or local infrastructure financing, until such time as the review of margins was concluded.

- On 25.11.20, the Chancellor announced the conclusion to the review of margins over gilt yields for PWLB rates; the standard and certainty margins were reduced by 1% but a prohibition was introduced to deny access to borrowing from the PWLB for any local authority which had purchase of assets for yield in its three year capital programme. The new margins over gilt yields are as follows: -.

  - **PWLB Standard Rate** is gilt plus 100 basis points (G+100bps)
  - **PWLB Certainty Rate** is gilt plus 80 basis points (G+80bps)

- **Borrowing for capital expenditure.** As Link's long-term forecast for Bank Rate is 2.00%, and all PWLB rates are under 2.00%, there is now value in borrowing from the PWLB for all types of capital expenditure for all maturity periods, especially as current rates are at historic lows. Longer-term borrowing could also be undertaken for the purpose of certainty, where that is desirable, or for flattening the profile of a heavily unbalanced maturity profile.

- While this authority will not be able to avoid borrowing to finance new capital expenditure, to replace maturing debt and the rundown of reserves, there will be a cost of carry, (the difference between higher borrowing costs and lower investment returns), to any new borrowing that causes a temporary increase in cash balances as this position will, most likely, incur a revenue cost.

Borrowing strategy

The PCC 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 PCC's reserves, balances and cash flow has been used as a temporary measure. This strategy is prudent as investment returns are low and counterparty risk is still an issue that needs to be considered.

Against this background and the risks within the economic forecast, caution will be adopted with the 2021/22 treasury operations. The Chief Finance Officer & S.151 Officer will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances:

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

- *if it was felt that there was a significant risk of a much sharper RISE in long and short term rates than that currently forecast,* perhaps arising from an acceleration in the rate of increase in central rates in the USA and UK, an increase in world economic activity, or a sudden increase in inflation risks, then the portfolio position will be re-appraised. Most likely, fixed rate funding will be drawn whilst interest rates are lower than they are projected to be in the next few years.

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

New financial institutions as a source of borrowing and / or types of borrowing

Currently the PWLB Certainty Rate is set at gilts + 80 basis points for both HRA and non-HRA borrowing. However, consideration may still need to be given to sourcing funding from the following sources for the following reasons:

- Local authorities (primarily shorter dated maturities out to 3 years or so – still cheaper than the Certainty Rate).
- Financial institutions (primarily insurance companies and pension funds but also some banks, out of forward dates where the objective is to avoid a "cost of carry" or to achieve refinancing certainty over the next few years).
- Municipal Bonds Agency (possibly still a viable alternative depending on market circumstances prevailing at the time).

Our advisors will keep us informed as to the relative merits of each of these alternative funding sources.

Approved Sources of Long and Short Term Borrowing

On Balance Sheet	**Fixed**	**Variable**
PWLB	●	●
Municipal bond agency	●	●
Local authorities	●	●
Banks	●	●
Pension funds	●	●
Insurance companies	●	●
Market (long-term)	●	●
Market (temporary)	●	●
Market (LOBOs)	●	●
Stock issues	●	●
Local temporary	●	●
Local Bonds	●	
Local authority bills	●	●
Overdraft		●
Negotiable Bonds	●	●
Internal (capital receipts & revenue balances)	●	●
Commercial Paper	●	
Medium Term Notes	●	
Finance leases	●	

ANNUAL INVESTMENT STRATEGY

Investment policy – management of risk

The MHCLG and CIPFA have extended the meaning of 'investments' to include both financial and non-financial investments. This report deals solely with financial investments, (as managed by the treasury management team). Non-financial investments, essentially the purchase of income yielding assets, are covered in the Capital Strategy, (a separate report).

The PCC's investment policy has regard to the following: -

- MHCLG's Guidance on Local Government Investments ("the Guidance")
- CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes 2017 ("the Code")
- CIPFA Treasury Management Guidance Notes 2018

The PCC's investment priorities will be security first, portfolio liquidity second and then yield, (return).

The above guidance from the MHCLG and CIPFA place a high priority on the management of risk. This PCC has adopted a prudent approach to managing risk and defines its risk appetite by the following means: -

1. Minimum acceptable **credit criteria** are applied in order to generate a list of highly creditworthy counterparties. This also enables diversification and thus avoidance of concentration risk. The key ratings used to monitor counterparties are the short term and long-term ratings.

2. **Other information:** ratings will not be the sole determinant of the quality of an institution; it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To achieve this consideration the PCC will engage with its advisors to maintain a monitor on market pricing such as **"credit default swaps"** and overlay that information on top of the credit ratings.

3. **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.

4. This PCC has defined the list of **types of investment instruments** that the treasury management team are authorised to use. There are two lists in appendix 4 under the categories of 'specified' and 'non-specified' investments.

   - **Specified investments** are those with a high level of credit quality and subject to a maturity limit of one year.
   - **Non-specified investments** are those with less high credit quality, may be for periods in excess of one year, and/or are more complex instruments which require greater consideration by the PCC and officers before being authorised for use.

5. **Non-specified investments limit.** The PCC has determined that it will limit the maximum total exposure to non-specified investments as being 10% of the total investment portfolio.

6. **Lending limits**, (amounts and maturity), for each counterparty will be set through applying the matrix table in the creditworthiness policy.

7. **Transaction limits** are set for each type of investment in the creditworthiness policy.

8. This PCC will set a limit for the amount of its investments which are invested for **longer than 365 days**.

9. Investments will only be placed with counterparties from countries with a specified minimum **sovereign rating**.

10. This PCC has engaged **external consultants**, to provide expert advice on how to optimise an appropriate balance of security, liquidity and yield, given the risk appetite of this PCC in the context of the expected level of cash balances and need for liquidity throughout the year.

11. All investments will be denominated in **sterling**.

Creditworthiness policy

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

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

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

The Chief Finance Officer & S.151 Officer will maintain a counterparty list in compliance with the following criteria and will revise the criteria and submit them to the PCC for approval as necessary. These criteria are separate to that which determines which types of investment instrument are either specified or non-specified as it provides an overall pool of counterparties considered high quality which the PCC may use, rather than defining what types of investment instruments are to be used.

Credit rating information is supplied by Link Asset Services, our treasury advisors, on all active counterparties that comply with the criteria below. Any counterparty failing to meet the criteria would be omitted from the counterparty (dealing) list. Any rating changes, rating Watches (notification of a likely change), rating Outlooks (notification of the longer-term bias outside the central rating view) are provided to officers almost immediately after they occur and this information is considered before dealing. For instance, a negative rating Watch applying to counterparty at the minimum PCC criteria will be suspended from use, with all others being reviewed in light of market conditions.

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

- Banks 1 - good credit quality **–** the PCC will only use banks which:
    i. are UK banks; and/or
    ii. are non-UK and domiciled in a country which has a minimum sovereign Long Term rating of AA-

  and have, as a minimum, the following Fitch, Moody's and Standard & Poor's credit ratings (where rated):

    i. Short Term – F1;

- Banks 2 – Part nationalised UK bank – Natwest Group. This bank can be included provided it continues to be part nationalised or it meets the ratings in Banks 1 above;

- Building societies - The PCC will *use* all societies which:
    i. Meet the ratings for banks outlined above;

- Money Market Funds – £2m limit (each). Subject to £6m maximum;
- Local authorities, Police and Fire and Crime Commissioners - £6m limit (each);
- Debt Management Office (DMO) - £no limit.

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

Time and monetary limits applying to investments. The time and monetary limits for institutions on the PCC's counterparty list are as follows (these will cover both specified and non-specified investments):

	Fitch Long-term Rating (or equivalent)	Money Limit	Transaction Limit	Time Limit
Individual Banks 1&2 higher quality	**F1+**	**£6m**	**£6m**	**364 days**
Individual Banks 1&2 medium Quality	**F1**	**£6m**	**£6m**	**364 days**
Individual UK Building societies	**F1+**	**£6m**	**£6m**	**364 days**
Individual UK Building societies	**F1**	**£6m**	**£6m**	**364 days**
Local authorities/Police, Fire and Crime Commissioners		**£6m**	**£6m**	**364 days**
Money Market Funds	**AAA**	**£2m (each)**	**£2m (each)**	**liquid**

The proposed criteria for specified and non-specified investments are shown in the appendices for approval.

No more than 30% of the total amount of investments will be invested with a single counterparty (with a minimum investment amount of £1m).

Country and sector limits
Due care will be taken to consider the country, group and sector exposure of the PCC's investments. The PCC has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of AA- from Fitch. The list of countries that qualify using this credit criteria as at the date of this report are shown in the appendices. This list will be added to, or deducted from, by officers should ratings change in accordance with this policy.
In addition:

- limits in place above will apply to a group of companies;
- sector limits will be monitored regularly for appropriateness.

Investment strategy

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

Investment returns expectations.
Bank Rate is unlikely to rise from 0.10% for a considerable period. It is very difficult to say when it may start rising so it may be best to assume that investment earnings from money market-related instruments will be sub 0.50% for the foreseeable future.

The suggested budgeted investment earnings rates for returns on investments placed for periods up to about three months during each financial year are as follows (the long term forecast is for periods over 10 years in the future):

Average earnings in each year	
2020/21	0.10%
2021/22	0.10%
2022/23	0.10%
2023/24	0.10%
2024/25	0.25%
Long term later years	2.00%

- The overall balance of risks to economic growth in the UK is probably now skewed to the upside, but is subject to major uncertainty due to the virus and how quickly successful vaccines may become available and widely administered to the population. It may also be affected by what, if any, deal the UK agrees as part of Brexit.
- There is relatively little UK domestic risk of increases or decreases in Bank Rate and significant changes in shorter term PWLB rates. The Bank of England has effectively ruled out the use of negative interest rates in the near term and increases in Bank Rate are likely to be some years away given the underlying economic expectations. However, it is always possible that safe haven flows, due to unexpected domestic developments and those in other major economies, or a return of investor confidence in equities, could impact gilt yields, (and so PWLB rates), in the UK.

Negative investment rates
While the Bank of England said in August / September 2020 that it is unlikely to introduce a negative Bank Rate, at least in the next 6 -12 months, and in November omitted any mention of negative rates in the minutes of the meeting of the Monetary Policy Committee, some deposit accounts are already offering negative rates for shorter periods. As part of the response to the pandemic and lockdown, the Bank and the Government have provided financial markets and businesses with plentiful access to credit, either directly or through commercial banks. In addition, the Government has provided large sums of grants to local authorities to help deal with the COVID crisis; this has caused some local authorities to have sudden large increases in cash balances searching for an investment home, some of which was only very short term until those sums were able to be passed on.

As for money market funds (MMFs), yields have continued to drift lower. Some managers have already resorted to trimming fee levels to ensure that net yields for investors remain in positive territory where possible and practical. Investor cash flow uncertainty, and the need to maintain liquidity in these unprecedented times, has meant there is a surfeit of money swilling around at the very short end of the market. This has seen a number of market operators, now including the DMADF, offer nil or negative rates for very short term maturities. This is not universal, and MMFs are still offering a marginally positive return, as are a number of financial institutions for investments at the very short end of the yield curve.

Inter-local authority lending and borrowing rates have also declined due to the surge in the levels of cash seeking a short-term home at a time when many local authorities are probably having difficulties over accurately forecasting when disbursements of funds received will occur or when further large receipts will be received from the Government.

Investment risk benchmarking
This PCC will use an investment benchmark to assess the investment performance of its investment portfolio of 3 month LIBID uncompounded.

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

Day to day Treasury Management
Currently Treasury Management Functions are provided by Kingston Upon Hull City Council under the terms of a service level agreement, following the decision to transfer them during the early part of 2020/21.

APPENDICES

1. Prudential and treasury indicators and MRP statement
2. Interest rate forecasts
3. Economic background
4. Treasury management practice 1 – credit and counterparty risk management
5. Approved countries for investments
6. Treasury management scheme of delegation
7. The treasury management role of the section 151 officer
8. Capital Strategy

Appendix 1

THE CAPITAL PRUDENTIAL AND TREASURY INDICATORS 2021/22 – 2024/25 AND MRP STATEMENT

The PCC's capital expenditure plans are the key driver of treasury management activity. The output of the capital expenditure plans is reflected in the prudential indicators, which are designed to assist the PCCs' overview and confirm capital expenditure plans.

Capital expenditure

Capital expenditure £m	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate
Total	18.097	28.573	7.179	3.521	8.390

Minimum revenue provision (MRP) policy statement

The PCC is required to pay off an element of the accumulated General Fund capital spend each year (the CFR) through a revenue charge (the minimum revenue provision - MRP), although it is also allowed to undertake additional voluntary payments if required (voluntary revenue provision - VRP).

CLG regulations have been issued which require the PCC to approve **an MRP Statement** in advance of each year. A variety of options are provided to authorities and PCCs, so long as there is a prudent provision. The PCC is recommended to approve the following MRP Statement:

The PCC has continued to adopt Option 2, the CFR approach in respect of pre-2007/08 debt as indicated above along with use of the asset life method of calculating the MRP for borrowing after that date by setting aside each year an amount that in simple terms equalled approximately 4% of the amount of capital expenditure financed from borrowing.

For post 2008 debt Option 3 is adopted, using the annuity method for calculating the MRP and that rate and amortisation period shall be determined by the PCC's Chief Finance Officer.

The annuity method is now widely used as it makes provision for an annual charge to revenue that takes account of the time value of money (whereby £100 in 10 years time is less of a burden than paying £100 now. The charges produced by the annuity method result in a consistent charge over the life of the asset taking into account he real value of the annual charges when they fall due. The method also reflects the fact that assets deteriorate and deterioration is slower in the early years and accelerates towards the latter end of the life of the assets. This approach conforms to the MHCLG requirement to make a prudent provision over a period which is broadly commensurate with the period that the capital expenditure provides benefit. The annuity calculation method results in lower MRP payments in the early years but higher payment in later years but has the advantage of linking MRP to the flow of benefits from an asset where these are expected to be in later years.

Affordability prudential indicators

The previous sections cover the overall capital and control of borrowing prudential indicators, but within this framework prudential indicators are required to assess the affordability of the capital investment plans. These provide an indication of the impact of the capital investment plans on the PCC's overall finances. The PCC is asked to approve the following indicators:

Ratio of financing costs to net revenue stream – Indicator 6
This indicator identifies the trend in the cost of capital (borrowing and other long-term obligation costs net of investment income) against the net revenue stream.

%	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate
Ratios	2.09%	2.84%	3.47%	3.86%	4.02%

The estimates of financing costs include current commitments and the proposals in this budget report.

Maturity structure of borrowing
Maturity structure of borrowing. These gross limits are set to reduce the PCC's exposure to large fixed rate sums falling due for refinancing, and are required for upper and lower limits.

The PCC is asked to approve the following treasury indicators and limits:

Maturity structure of fixed interest rate borrowing 2021/22 – Indicator 7		
	Lower	**Upper**
Under 12 months	0	15%
12 months to 2 years	0	15%
2 years to 5 years	0	30%
5 years to 10 years	0	60%
10 years and above	0	80%

Appendix 2

Interest Rate Forecasts 2021 – 2024

Market Rates											
	Equities				Currencies			Commodities		Risk Indicators	
	FTSE 100	DOW	NIKKEI	STX 600	£/$	€/£	€/$	Brent	Gold	VIX	MOVE
Level	6,489.33	31,148.24	29,388.50	409.54	1.3728	1.1405	1.2037	59.82	1,815.70	20.8700	47.2000
Change	-0.22%	0.30%	2.12%	0.00%	0.46%	-0.24%	0.69%	0.85%	1.12%	-4.13%	-0.11%

Interest Rates												Average LIBID / LIBOR Rates		
O/n	1W	1M	3M	6M	9M	12M	24M	36M	48M	60M	SONIA	7D LIBID	3M LIBID	3M LIBOR
0.05	0.05	0.05	0.05	0.05	0.1	0.15	0.2	0.3	0.4	0.5	0.0484	-0.07%	0.03%	0.15%

PWLB (Includes Certainty Rate)					Forward Rates			
1y	5y	10y	25y	50y	3M/3M FWD	3M/6M FWD	3M/9M FWD	6M/12M FWD
0.77	0.96	1.35	1.92	1.76	0.00	-0.02	-0.03	0.22

Interest Rate Forecasts								
Bank Rate	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22
Link	0.10%	0.10%	0.10%	0.10%	0.10%	0.10%	0.10%	0.10%
Cap Econ	0.10%	0.10%	0.10%	0.10%	0.10%	0.10%	0.10%	0.10%
5Y PWLB RATE								
Link	0.80%	0.80%	0.80%	0.80%	0.90%	0.90%	0.90%	0.90%
Cap Econ	0.85%	0.90%	0.90%	0.95%	0.95%	0.95%	0.95%	0.95%
10Y PWLB RATE								
Link	1.10%	1.10%	1.10%	1.10%	1.20%	1.20%	1.20%	1.20%
Cap Econ	1.25%	1.25%	1.30%	1.30%	1.30%	1.30%	1.30%	1.30%
25Y PWLB RATE								
Link	1.50%	1.60%	1.60%	1.60%	1.60%	1.70%	1.70%	1.70%
Cap Econ	1.80%	1.80%	1.80%	1.80%	1.80%	1.80%	1.80%	1.80%
50Y PWLB RATE								
Link	1.30%	1.40%	1.40%	1.40%	1.40%	1.50%	1.50%	1.50%
Cap Econ	1.65%	1.70%	1.70%	1.70%	1.70%	1.70%	1.70%	1.70%

Appendix 3

ECONOMIC BACKGROUND

- **UK.** The key quarterly meeting of the Bank of England Monetary Policy Committee kept **Bank Rate** unchanged on 5.11.20. However, it revised its economic forecasts to take account of a second national lockdown from 5.11.20 to 2.12.20 which is obviously going to put back economic recovery and do further damage to the economy. It therefore decided to do a further tranche of **quantitative easing (QE) of £150bn**, to start in January when the current programme of £300bn of QE, announced in March to June, runs out. It did this so that "announcing further asset purchases now should support the economy and help to ensure the unavoidable near-term slowdown in activity was not amplified by a tightening in monetary conditions that could slow the return of inflation to the target".
- Its forecasts appeared, at that time, to be rather optimistic in terms of three areas:
    - The economy would recover to reach its pre-pandemic level in Q1 2022
    - The Bank also expected there to be excess demand in the economy by Q4 2022.
    - CPI inflation was therefore projected to be a bit above its 2% target by the start of 2023 and the "inflation risks were judged to be balanced".
- Significantly, there was no mention of **negative interest rates** in the minutes or Monetary Policy Report, suggesting that the MPC remains some way from being persuaded of the case for such a policy, at least for the next 6 -12 months. However, rather than saying that it "stands ready to adjust monetary policy", the MPC this time said that it will take "whatever additional action was necessary to achieve its remit". The latter seems stronger and wider and may indicate the Bank's willingness to embrace new tools.
- One key addition to **the Bank's forward guidance in August** was a new phrase in the policy statement, namely that "it does not intend to tighten monetary policy until there is clear evidence that significant progress is being made in eliminating spare capacity and achieving the 2% target sustainably". That seems designed to say, in effect, that even if inflation rises to 2% in a couple of years' time, do not expect any action from the MPC to raise Bank Rate – until they can clearly see that level of inflation is going to be persistently above target if it takes no action to raise Bank Rate. Our Bank Rate forecast currently shows no increase, (or decrease), through to quarter 1 2024 but there could well be no increase during the next five years as it will take some years to eliminate spare capacity in the economy, and therefore for inflationary pressures to rise to cause the MPC concern. **Inflation** is expected to briefly peak at just over 2% towards the end of 2021, but this is a temporary short lived factor due to base effects from twelve months ago falling out of the calculation, and so is not a concern. Looking further ahead, it is also unlikely to be a problem for some years as it will take a prolonged time for spare capacity in the economy, created by this downturn, to be used up.

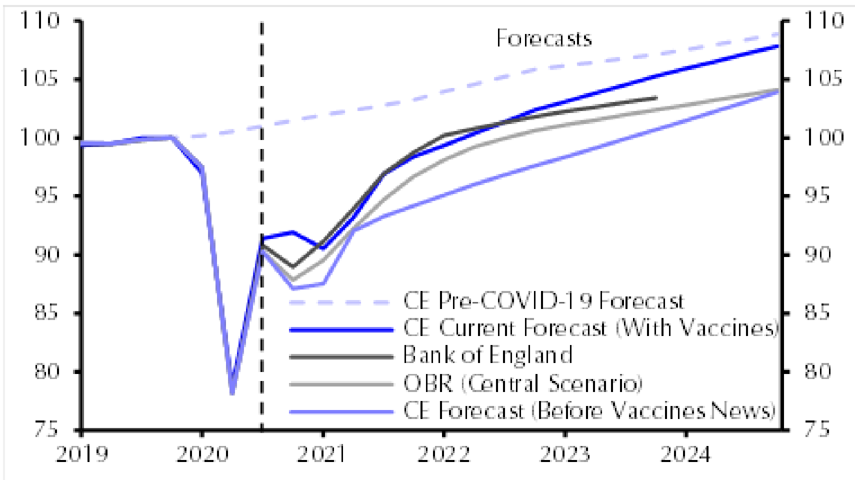
- **Public borrowing** was forecast in November by the Office for Budget Responsibility (the OBR) to reach £394bn in the current financial year, the highest ever peace time deficit and equivalent to 19% of GDP. In normal times, such an increase in total gilt issuance would lead to a rise in gilt yields, and so PWLB rates. However, the QE done by the Bank of England has depressed gilt yields to historic low levels, (as has similarly occurred with QE and debt issued in the US, the EU and Japan). This means that new UK debt being issued, and this is being done across the whole yield curve in all maturities, is locking in those historic low levels through until maturity. In addition, the UK has one of the longest average maturities for its entire debt portfolio, of any country in the world. Overall, this means that the total interest bill paid by the Government is manageable despite the huge increase in the total amount of debt. The OBR was also forecasting that the government will still be running a budget deficit of £102bn (3.9% of GDP) by 2025/26. However, initial impressions are that they have taken a pessimistic view of the impact that vaccines could make in the speed of economic recovery.

- Overall, **the pace of recovery** was not expected to be in the form of a rapid V shape, but a more elongated and prolonged one. The initial recovery was sharp after quarter 1 saw growth at -3.0% followed by -18.8% in quarter 2 and then an upswing of +16.0% in quarter 3; this still left the economy 8.6% smaller than in Q4 2019. While the one month second national lockdown that started on 5th November caused a further contraction of 5.7% m/m in November, this was much better than had been feared and showed that the economy is adapting to new ways of working. This left the economy 'only' 8.6% below the pre-crisis level.

- **Vaccines – the game changer.** The Pfizer announcement on 9th November of a successful vaccine has been followed by approval of the Oxford University/AstraZeneca and Moderna vaccines. The Government has a set a target to vaccinate 14 million people in the most at risk sectors of the population by 15th February; as of mid-January, it has made good, and accelerating progress in hitting that target. The aim is to vaccinate all adults by September. This means that the national lockdown starting in early January, could be replaced by regional tiers of lighter restrictions, beginning possibly in Q2. At that point, there would be less reason to fear that hospitals could become overwhelmed any more. Effective vaccines have radically improved the economic outlook so that it may now be possible for GDP to recover to its pre-virus level as early as Q1 2022. These vaccines have enormously boosted confidence that **life could largely return to normal during the second half of 2021**. With the household saving rate having been exceptionally high since the first lockdown in March, there is plenty of pent-up demand and purchasing power stored up for when life returns to normal.

- Provided that both monetary and fiscal policy are kept loose for a few years yet, then it is still possible that in the second half of this decade, the economy may be no smaller than it would have been if COVID-19 never happened. The significant risk is if another mutation of COVID-19 appears that defeats the current batch of vaccines. However, now that science and technology have caught up with understanding this virus, new vaccines ought to be able to be developed more quickly to counter such a development, and vaccine production facilities are being ramped up around the world.

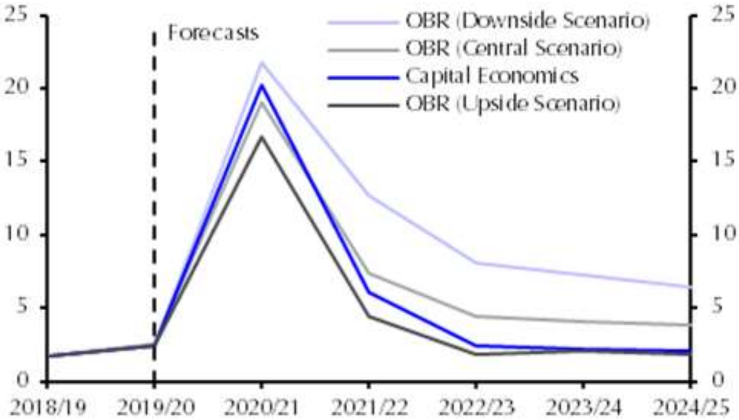
Chart: Level of real GDP (Q4 2019 = 100)



(if unable to print in colour...... the key describing each line in the above graph is in sequential order from top to bottom in parallel with the lines in the graph.

This recovery of growth which eliminates the effects of the pandemic by about the middle of the decade, would have major repercussions for public finances as it would be consistent with the government deficit falling to around 2.5% of GDP without any tax increases. This would be in line with the OBR's most optimistic forecast in the graph below, rather than their current central scenario which predicts a 4% deficit due to assuming much slower growth. However, Capital Economics forecasts assumed that politicians do not raise taxes or embark on major austerity measures and so, (perversely!), depress economic growth and recovery.

Chart: Public Sector Net Borrowing (as a % of GDP)



(if unable to print in colour...... the key describing each line in the above graph is in sequential order from top to bottom in parallel with the lines in the graph.

- There will still be some **painful longer term adjustments** as e.g. office space and travel by planes, trains and buses may not recover to their previous level of use for several years, or possibly ever, even if vaccines are fully successful in overcoming the current virus. There is also likely to be a **reversal of globalisation** as this crisis has exposed how vulnerable long-distance supply chains are. On the other hand, **digital services** are one area that has already seen huge growth.

- **Brexit.** The final agreement of a trade deal on 24.12.20 has eliminated a significant downside risk for the UK economy. The initial agreement only covers trade so there is further work to be done on the services sector where temporary equivalence has been granted in both directions between the UK and EU; that now needs to be formalised on a permanent basis. As the forecasts in this report were based on an assumption of a Brexit agreement being reached, there is no need to amend these forecasts.

- **Monetary Policy Committee meeting of 17 December.** All nine Committee members voted to keep interest rates on hold at +0.10% and the Quantitative Easing (QE) target at £895bn. The MPC commented that the successful rollout of vaccines had reduced the downsides risks to the economy that it had highlighted in November. But this was caveated by it saying, "Although all members agreed that this would reduce downside risks, they placed different weights on the degree to which this was also expected to lead to stronger GDP growth in the central case." So, while vaccines are a positive development, in the eyes of the MPC at least, the economy is far from out of the woods in the shorter term. The MPC, therefore, voted to extend the availability of the Term Funding Scheme, (cheap borrowing), with additional incentives for small and medium size enterprises for six months from 30.4.21 until 31.10.21. (The MPC had assumed that a Brexit deal would be agreed.)

- **Fiscal policy.** At the budget in early March, the Chancellor made the following commitments:-

    - An extension of the COVID-19 loan schemes from the end of January 2021 to the end of September 2021.
    - The furlough scheme was lengthened from the end of March to the end of September 2021.

- The **Financial Policy Committee** (FPC) report on 6.8.20 revised down their expected credit losses for the banking sector to "somewhat less than £80bn". It stated that in its assessment, "banks have buffers of capital more than sufficient to absorb the losses that are likely to arise under the MPC's central projection". The FPC stated that for real stress in the sector, the economic output would need to be twice as bad as the MPC's projection, with unemployment rising to above 15%.

- **US.** The Democrats gained the presidency and a majority in the House of Representatives in the November elections: after winning two key Senate seats in Georgia in elections in early January, they now also have a very slim majority in the Senate due to the vice president's casting vote. President Biden will consequently have a much easier path to implement his election manifesto. However, he will not have a completely free hand as more radical Democrat plans may not be supported by all Democrat senators. His initial radical plan for a fiscal stimulus of $1.9trn, (9% of GDP), is therefore likely to be toned down in order to get through both houses.

- **The economy** had been recovering quite strongly from its contraction in 2020 of 10.2% due to the pandemic with GDP only 3.5% below its pre-pandemic level and the unemployment rate dropping below 7%. However, the rise in new cases during quarter 4, to the highest level since mid-August, suggests that the US could be in the early stages of a fourth wave. The latest upturn poses a threat that the recovery in the economy could stall. This is **the single biggest downside risk** to the shorter term outlook – a more widespread and severe wave of infections over the winter months, which is compounded by the impact of the regular flu season and, as a consequence, threatens to overwhelm health care facilities. Under those circumstances, individual states might feel it necessary to return to more draconian lockdowns.

- The restrictions imposed to control the spread of the virus are once again weighing on the economy with employment growth slowing sharply in November and declining in December, and retail sales dropping back. The economy is set for further weakness into the spring. **GDP growth** is expected to rebound markedly from the second quarter of 2021 onwards as vaccines are rolled out on a widespread basis and restrictions are loosened.

- After Chair Jerome Powell unveiled the **Fed's adoption of a flexible average inflation target** in his Jackson Hole speech in late August 2020, the mid-September meeting of the Fed agreed by a majority to a toned down version of the new inflation target in his speech - that *"it would likely be appropriate to maintain the current target range until labour market conditions were judged to be consistent with the Committee's assessments of maximum employment and inflation had risen to 2% and was on track to moderately exceed 2% for some time."* This change was aimed to provide more stimulus for economic growth and higher levels of employment and to avoid the danger of getting caught in a deflationary "trap" like Japan. It is to be noted that inflation has actually been under-shooting the 2% target significantly for most of the last decade, (and this year), so financial markets took note that higher levels of inflation are likely to be in the pipeline; long-term bond yields duly rose after the meeting. The FOMC's updated economic and rate projections in mid-September showed that officials expect to leave the fed funds rate at near-zero until at least end-2023 and probably for another year or two beyond that. There is now some expectation that where the Fed has led in changing its inflation target, other major central banks will follow. The increase in tension over the last year between the US and China is likely to lead to a lack of momentum in progressing the initial positive moves to agree a phase one trade deal.

- The Fed's meeting on **5 November** was unremarkable - but at a politically sensitive time around the elections. At its **16 December** meeting the Fed tweaked the guidance for its monthly asset quantitative easing purchases with the new language implying those purchases could continue for longer than previously believed. Nevertheless, with officials still projecting that **inflation** will only get back to 2.0% in 2023, the vast majority expect the Fed funds rate to be still at near-zero until 2024 or later. Furthermore, officials think the balance of risks surrounding that median inflation forecast are firmly skewed to the downside. The key message is still that policy will remain unusually accommodative – with near-zero rates and asset purchases – continuing for several more years. This is likely to result in keeping Treasury yields low – which will also have an influence on gilt yields in this country.

- **EU.** In early December, the figures for Q3 GDP confirmed that the economy staged a rapid rebound from the first lockdowns. This provides grounds for optimism about growth prospects for next year. In Q2, GDP was 15% below its pre-pandemic level. But in Q3 the economy grew by 12.5% q/q leaving GDP down by "only" 4.4%. That was much better than had been expected earlier in the year. However, growth is likely to stagnate during Q4 and in Q1 of 2021, as a second wave of the virus has seriously affected many countries. The €750bn fiscal support package eventually agreed by the EU after prolonged disagreement between various countries, is unlikely to provide significant support, and quickly enough, to make an appreciable difference in the countries most affected by the first wave.

- With **inflation** expected to be unlikely to get much above 1% over the next two years, **the ECB** has been struggling to get inflation up to its 2% target. It is currently unlikely that it will cut its central rate even further into negative territory from -0.5%, although the ECB has stated that it retains this as a possible tool to use. The ECB's December meeting added a further €500bn to the PEPP scheme, (purchase of government and other bonds), and extended the duration of the programme to March 2022 and re-investing maturities for an additional year until December 2023. Three additional tranches of TLTRO, (cheap loans to banks), were approved, indicating that support will last beyond the impact of the pandemic, implying indirect yield curve control for government bonds for some time ahead. The Bank's forecast for a return to pre-virus activity levels was pushed back to the end of 2021, but stronger growth is projected in 2022. The total PEPP scheme of €1,850bn of QE which started in March 2020 is providing protection to the sovereign bond yields of weaker countries like Italy. There is therefore unlikely to be a euro crisis while the ECB is able to maintain this level of support. However, as in the UK and the US, the advent of highly effective vaccines will be a game changer, although growth will struggle before later in quarter 2 of 2021.

- **China.** After a concerted effort to get on top of the virus outbreak in Q1, economic recovery was strong in Q2 and then into Q3 and Q4; this has enabled China to recover all of the contraction in Q1. Policy makers have both quashed the virus and implemented a programme of monetary and fiscal support that has been particularly effective at stimulating short-term growth. At the same time, China's economy has benefited from the shift towards online spending by consumers in developed markets. These factors help to explain its comparative outperformance compared to western economies. However, this was achieved by major central government funding of yet more infrastructure spending. After years of growth having been focused on this same area, any further spending in this area is likely to lead to increasingly weaker economic returns in the longer term. This could, therefore, lead to a further misallocation of resources which will weigh on growth in future years.

- **Japan.** A third round of fiscal stimulus in early December took total fresh fiscal spending this year in response to the virus close to 12% of pre-virus GDP. That's huge by past standards, and one of the largest national fiscal responses. The budget deficit is now likely to reach 16% of GDP this year. Coupled with Japan's relative success in containing the virus without draconian measures so far, and the likelihood of effective vaccines being available in the coming months, the government's latest fiscal effort should help ensure a strong recovery and to get back to pre-virus levels by Q3 2021 – around the same time as the US and much sooner than the Eurozone.

- **World growth.** World growth will has been in recession in 2020 and this is likely to continue into the first half of 2021 before recovery in the second half. Inflation is unlikely to be a problem for some years due to the creation of excess production capacity and depressed demand caused by the coronavirus crisis.

- Until recent years, world growth has been boosted by increasing **globalisation** i.e. countries specialising in producing goods and commodities in which they have an economic advantage and which they then trade with the rest of the world. This has boosted worldwide productivity and growth, and, by lowering costs, has also depressed inflation. However, the rise of China as an economic superpower over the last thirty years, which now accounts for nearly 20% of total world GDP, has unbalanced the world economy. The Chinese government has targeted achieving major world positions in specific key sectors and products, especially high tech areas and production of rare earth minerals used in high tech products. It is achieving this by massive financial support, (i.e. subsidies), to state owned firms, government directions to other firms, technology theft, restrictions on market access by foreign firms and informal targets for the domestic market share of Chinese producers in the selected sectors. This is regarded as being unfair competition that is putting western firms at an unfair disadvantage or even putting some out of business. It is also regarded with suspicion on the political front as China is an authoritarian country that is not averse to using economic and military power for political advantage. The current trade war between the US and China therefore needs to be seen against that backdrop. It is, therefore, likely that we are heading into a period where there will be a **reversal of world globalisation and a decoupling of western countries** from dependence on China to supply products. This is likely to produce a backdrop in the coming years of weak global growth and so weak inflation.

Summary

Central banks are, therefore, likely to support growth by maintaining loose monetary policy through keeping rates very low for longer. Governments could also help a quicker recovery by providing more fiscal support for their economies at a time when total debt is affordable due to the very low rates of interest. They will also need to avoid significant increases in taxation or austerity measures that depress demand and the pace of recovery in their economies.

If there is a huge surge in investor confidence as a result of successful vaccines which leads to a major switch out of government bonds into equities, which, in turn, causes government debt yields to rise, then there will be pressure on central banks to actively manage debt yields by further QE purchases of government debt; this would help to suppress the rise in debt yields and so keep the total interest bill on greatly expanded government debt portfolios within manageable parameters. It is also the main alternative to a programme of austerity.

Appendix 4

TREASURY MANAGEMENT PRACTICE – CREDIT AND COUNTERPARTY RISK MANAGEMENT

SPECIFIED INVESTMENTS:
(All such investments will be sterling denominated, with **maturities up to maximum of 1 year**, meeting the minimum 'high' rating criteria where applicable)

	Minimum 'High' Credit Criteria	**Use**
Debt Management Agency Deposit Facility	--	In-house
Term deposits – local authorities	--	In-house
Term deposits – banks and building societies	F1	In-house

Term deposits with nationalised banks and banks and building societies

	Minimum Credit Criteria	**Use**	**Max % of total investments**	**Max. maturity period**
UK part nationalised banks	UK sovereign rating or Short-term F1, Sovereign rating AA-	In-house	**50%**	**364 days**
Banks part nationalised by high credit rated (sovereign rating) countries – non UK	Sovereign rating or Short-term F1, Sovereign rating AA-	In-house	**50%**	**364 days**

Collective Investment Schemes structured as Open Ended Investment Companies (OEICs): -		
1. Money Market Funds	AAA rated	In-house

Accounting treatment of investments. The accounting treatment may differ from the underlying cash transactions arising from investment decisions made by this PCC. To ensure that the PCC is protected from any adverse revenue impact, which may arise from these differences, we will review the accounting implications of new transactions before they are undertaken.

NON-SPECIFIED INVESTMENTS: The PCC will not make investments longer than 1 year

TREASURY MANAGEMENT PRACTICE (TMP1) – CREDIT AND COUNTERPARTY RISK MANAGEMENT

The MHCLG issued Investment Guidance in 2018, and this forms the structure of the PCC's policy below. These guidelines do not apply to either trust funds or pension funds which operate under a different regulatory regime.

The key intention of the Guidance is to maintain the current requirement for authorities and PCCs to invest prudently, and that priority is given to security and liquidity before yield. In order to facilitate this objective the guidance requires this PCC to have regard to the CIPFA publication Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes. The PCC adopted the Code on 15/02/2010 and will apply its principles to all investment activity. In accordance with the Code, the Chief Finance Officer and S.151 Officer has produced its treasury management practices (TMPs). This part, TMP 1(1), covering investment counterparty policy requires approval each year.

Annual investment strategy - The key requirements of both the Code and the investment guidance are to set an annual investment strategy, as part of its annual treasury strategy for the following year, covering the identification and approval of following:

- The strategy guidelines for choosing and placing investments, particularly non-specified investments;
- The principles to be used to determine the maximum periods for which funds can be committed;
- Specified investments that the PCC will use. These are high security (i.e. high credit rating, although this is defined by the PCC, and no guidelines are given), and high liquidity investments in sterling and with a maturity of no more than a year;
- Non-specified investments, clarifying the greater risk implications, identifying the general types of investment that may be used and a limit to the overall amount of various categories that can be held at any time.

The investment policy proposed for the PCC is:

Strategy guidelines – The main strategy guidelines are contained in the body of the treasury strategy statement.

Specified investments – These investments are sterling investments of not more than one-year maturity. These are considered low risk assets where the possibility of loss of principal or investment income is small. These would include sterling investments which would not be defined as capital expenditure with:

1. The UK Government (such as the Debt Management Account deposit facility, UK treasury bills or a gilt with less than one year to maturity).
2. Supranational bonds of less than one year's duration.
3. A local authority, housing association, parish council or community council.
4. Pooled investment vehicles (such as money market funds) that have been awarded a high credit rating by a credit rating agency. For category 4 this covers pooled investment vehicles, such as money market funds, rated AAA by Standard and Poor's, Moody's and / or Fitch rating agencies.
5. A body that is considered of a high credit quality (such as a bank or building society For category 5 this covers bodies with a minimum Short Term rating of F1 (or the equivalent) as rated by Standard and Poor's, Moody's and / or Fitch rating agencies .

Within these bodies, and in accordance with the Code, the PCC has set additional criteria to set the time and amount of monies which will be invested in these bodies.

Non-specified investments –are any other type of investment (i.e. not defined as specified above). The PCC will not use these types of investments.

The monitoring of investment counterparties - The credit rating of counterparties will be monitored regularly. The PCC receives credit rating information (changes, rating watches and rating outlooks) from Link Asset Services as and when ratings change, and counterparties are checked promptly. On occasion ratings may be downgraded when an investment has already been made. The criteria used are such that a minor downgrading should not affect the full receipt of the principal and interest. Any counterparty failing to meet the criteria will be removed from the list immediately by the Chief Finance Officer & S.151 Officer, and if required new counterparties which meet the criteria will be added to the list.

Appendix 5

This list is based on those countries which have sovereign ratings of AA- or higher, (we show the lowest rating from Fitch, Moody's and S&P) and also, (except - at the time of writing - for Hong Kong, Norway and Luxembourg), have banks operating in sterling markets which have credit ratings of green or above in the Link Asset Services credit worthiness service.

Based on lowest available rating

AAA

- Australia
- Denmark
- Germany
- Luxembourg
- Netherlands
- Norway
- Singapore
- Sweden
- Switzerland

AA+

- Canada
- Finland
- U.S.A.

AA

- Abu Dhabi (UAE)
- France

AA-

- Belgium
- Hong Kong
- Qatar
- U.K.

Appendix 6

TREASURY MANAGEMENT SCHEME OF DELEGATION

Police and Crime Commissioner

- receiving and reviewing reports on treasury management policies, practices and activities;
- approval of annual strategy;
- approval of/amendments to the organisation's adopted clauses, treasury management policy statement and treasury management practices;
- budget consideration and approval;
- approval of the division of responsibilities;
- receiving and reviewing regular monitoring reports and acting on recommendations;
- approving the selection of external service providers and agreeing terms of appointment;
- reviewing the treasury management policy and procedures and making recommendations to the responsible body.

Appendix 7

THE TREASURY MANAGEMENT ROLE OF THE SECTION 151 OFFICER

The S151 (responsible) officer

- recommending clauses, treasury management policy/practices for approval, reviewing the same regularly, and monitoring compliance;
- submitting regular treasury management policy reports;
- submitting budgets and budget variations;
- receiving and reviewing management information reports;
- reviewing the performance of the treasury management function;
- ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function;
- ensuring the adequacy of internal audit, and liaising with external audit;
- recommending the appointment of external service providers;
- preparation of a capital strategy to include capital expenditure, capital financing, non-financial investments and treasury management, with a long term timeframe;
- ensuring that the capital strategy is prudent, sustainable, affordable and prudent in the long term and provides value for money;
- ensuring that due diligence has been carried out on all treasury and non-financial investments and is in accordance with the risk appetite of the PCC;
- ensure that the PCC has appropriate legal powers to undertake expenditure on non-financial assets and their financing;
- ensuring the proportionality of all investments so that the PCC does not undertake a level of investing which exposes the PCC to an excessive level of risk compared to its financial resources;
- ensuring that an adequate governance process is in place for the approval, monitoring and ongoing risk management of all non-financial investments and long term liabilities;
- provision of a schedule of all non-treasury investments including material investments in subsidiaries, joint ventures, loans and financial guarantees;
- ensuring that there is an adequate understanding of the risk exposures taken on by the PCC;
- ensuring that the PCC has adequate expertise, either in house or externally provided, to carry out the above;
- creation of Treasury Management Practices which specifically deal with how non treasury investments will be carried out and managed, to include the following:-
    - *Risk management (TMP1 and schedules), including investment and risk management criteria for any material non-treasury investment portfolios;*

Appendix 8

CAPITAL STRATEGY

1. Introduction

1.1 There is a new requirement on local authorities (including Police and Crime Commissioners) to prepare a capital strategy each year, which sets out our approach to capital expenditure and financing at a high level. The requirement to prepare a strategy arises from Government concerns about a small number of authorities borrowing substantial sums (relative to their budget) to invest in commercial property, often outside the area of the authority concerned.

1.2 There is also a new requirement on local authorities to prepare an investment strategy, which specifies our approach to making investments other than day to day treasury management investments (the latter is included in our treasury management strategy, as in previous years). Given that the Police and Crime Commissioner for Humberside makes no such investments, a strategy has not been prepared.

1.3 This Appendix sets out the proposed capital strategy for approval.

2. Capital Expenditure

2.1 The capital expenditure plans are approved by the PCC, as part of the budget report each year.

2.2 The capital programme is usually restricted to:-

(a) Investment in operational buildings – e.g. stations and administrative offices;

(b) Renewal of operational fleet;

(c) New and replacement equipment;

(d) Investment in ICT.

2.3 The PCC's Code of Corporate Governance sets out the delegations to the Chief Constable on the delivery of the capital programme.

2.4 Capital expenditure on **buildings**, where funded from the capital programme, is principally directed to maintaining the fitness of the operational estate. Major property investments are considered as part of the overall estates strategy.

2.5 Expenditure on the **renewal of the fleet** is directed by the replacement programme approved by the PCC.

2.6 Capital expenditure on **operational equipment** ensures equipment is replaced when it has reached the end of its useful life or has become technologically obsolescent. It also enables the PCC to invest in new technology.

2.7 Capital expenditure on **ICT** is determined by the ICT replacement and Improvement programme which is approved by the PCC.

2.8 Monitoring of capital expenditure is carried out by the COG; the Accountability Board, Joint Independent Audit Committee and the PCC. Reports are presented throughout the year and at outturn.

2.9 the PCC does not capitalise expenditure, except where it can do so in compliance with proper practices: it does not apply for directions to capitalise revenue expenditure.

2.10 Past and forecast capital expenditure is:-

End of:	£m
19/20	8.747
20/21	18.097
21/22	28.573
22/23	7.179
23/24	3.521
24/25	8.390

3. Financing of Capital Expenditure

3.1 The PCC funds capital expenditure from the revenue budget, capital receipts and prudential borrowing.

3.2 Prudential borrowing is used to fund capital expenditure, within the limits prescribed within the Annual Treasury Management Strategy Statement. This is reviewed annually for affordability.

3.3 The PCC measures its capital financial requirement, which shows our underlying need to borrow for a capital purpose. This is shown in the table below:-

End of:	Total CFR
	£000
21/22	127.031
22/23	128.869
23/24	126.014
24/25	127.413

3.4 Projections of actual debt are part of the treasury management indicators in the Annual Treasury Management Strategy Statement.

4. Debt Repayment

4.1 The PCC is required to pay off an element of the accumulated General Fund capital spend each year (the CFR) through a revenue charge (the minimum revenue provision - MRP), although it is also allowed to undertake additional voluntary payments if required (voluntary revenue provision - VRP).

CLG regulations have been issued which require the PCC to approve **an MRP Statement** in advance of each year. A variety of options are provided to authorities and PCCs, so long as there is a prudent provision. The PCC is recommended to approve the following MRP Statement:

The PCC has continued to adopt Option 2, the CFR approach in respect of pre-2007/08 debt as indicated above along with use of the asset life method of calculating the MRP for borrowing after that date by setting aside each year an amount that in simple terms equalled approximately 4% of the amount of capital expenditure financed from borrowing.

For post 2008 debt Option 3 be adopted, using the annuity method for calculating the MRP and that rate and amortisation period shall be determined by the PCC's Chief Finance Officer.

The annuity method is now widely used as it makes provision for an annual charge to revenue that takes account of the time value of money (whereby £100 in 10 years tome is less of a burden than paying £100 now. The charges produced by the annuity method result in a consistent charge over the life of the asset taking into account he real value of the annual charges when they fall due. The method also reflects the fact that assets deteriorate and deterioration is slower in the early years and accelerates towards the latter end of the life of the assets. This approach conforms to the MHCLG requirement to make a prudent provision over a period which is broadly commensurate with the period that the capital expenditure provides benefit. The annuity calculation method results in lower MRP payments in the early years but higher payment in later years but has the advantage of linking MRP to the flow of benefits from an asset where these are expected to be in later years.

5. Commercial Activity

5.1 Government guidance now requires us to specify our policy towards non-financial investments.

5.2 The PCC makes no such investments.