Appendix 1

Corporate Finance

Treasury Management Strategy 2024/25

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Treasury Management Strategy (TMS) 2024/25

1.0 Introduction

1.1 Treasury Management is the management of the PFCC's cash flows, borrowing and investments, and the associated risks.

1.2 The PFCC invests substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of financial risks are therefore central to the PFCC's prudent financial management.

1.3 Treasury risk management at the PFCC 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 PFCC to approve a Treasury Management Strategy (TMS) before the start of each financial year. This report fulfils the PFCC's legal obligation under the Local Government Act 2003 to have regard to the CIPFA Code.

1.4 One of the main aspects of treasury management is to ensure that cash flow is adequately planned to ensure that cash is available when needed to meet payments when they are due. If not immediately needed any surplus monies are invested in low-risk counterparties in order to earn interest.

1.5 In addition to ensuring the above issues are managed effectively and the PFCC complies with its legal obligations, the other main purpose of the TMS is to assess the financing requirement of the PFCC's capital investment plans, and the level of borrowing required for that expenditure.

1.6 Whilst the TMS sets out a borrowing strategy in section 3, it should be noted that individual instances of external borrowing may still require separate approval if the value and/or duration meets certain criteria. Further detail of the PFCC's process for approving external borrowing is set out in paragraphs 3.15 - 3.17.

1.7 There are no material changes from the 2023/24 TMS however the report has been fully updated based on the latest Capital Programme approved as part of the 2024/25 budget setting process. In addition, the previous table included within the Borrowing Strategy listing specific thresholds for certain types of borrowing has now been removed. This is explained further within section 3 of the report.

2.0 Local Context

2.1 On the 29th February 2024 the PFCC held £15.347m of cash and investments with no external borrowings (31st March 2023, £5.109m). These investments are set out in further detail in Appendix A.

2.2 Treasury performance is reported on a monthly basis to the PFCC's Chief Financial Officer within the monthly monitoring report, summarising the previous month performance with explanations for any key variances. In addition, a monthly plan is prepared setting out proposed investment/borrowing activity for the month ahead.

2.3 A quarterly TM report is also prepared for the PFCC's Strategic Board, setting out cashflow performance for the previous quarter as well as the onward forecast for the remainder of the financial year, including any requirement for external borrowing. Where certain conditions are met, as set out elsewhere within this report, a decision report is submitted to the PFCC office for approval of the external borrowing.

2.4 The current medium-term Capital Programme is the significant driver for both the cashflow and the PFCC's funding requirements, which encompasses the strategic objectives of the force over the next five years.

2.5 The Capital Programme presented to the Police, Fire & Crime Panel on the 1st February 2024 included approved projects as well as schemes that are still subject to a full business case prior to approval. The impact on the UK from higher interest rates and inflation, a weakening economic outlook, an uncertain political climate due to an upcoming general election, together with the war in Ukraine and the Middle East, will all be major influences on the PFCC's TMS in 2024/25. These global, economic and political issues also impacting the availability of materials continues to influence the PFCC's Capital Programme, which is volatile and subject to change, resulting in delays and further capital slippage. The detail of the Capital Programme for 2024/25 onwards is included in the Capital Strategy (Appendix 3 of this report).

CFR and MRP Summary

2.6 The underlying need to borrow for capital purposes is measured by the CFR, while usable reserves and working capital are the underlying resources available for investment. The PFCC's strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing. However, because the PFCC has an increasing CFR over the medium-term due to the capital programme, with investments also decreasing over this period, internal borrowing will no longer be feasible and external borrowing will therefore increase. This financing requirement is set out in Table 1 below, whilst the proposed approach in dealing with these deficits is explained further in the borrowing strategy section of this document.

Table 1 – CFR and MRP Summary

CAPITAL PROGRAMME - 2024/25 BUDGET SETTING

CFR & MRP SUMMARY

	2023/24 £000	2024/25 £000	2025/26 £000	2026/27 £000	2027/28 £000	2028/29 £000	TOTAL £000
Opening CFR	**17,028**	**25,572**	**41,739**	**50,038**	**68,160**	**79,959**	**17,028**
Capital Expenditure							
Approved projects - long-life	7,542	6,681	99	-	-	-	14,322
Approved projects - short-life	8,030	7,434	772	92	-	-	16,328
Subject to Approval projects - long-life	-	1,140	6,879	15,713	8,965	8,300	40,997
Subject to Approval projects - short-life	186	7,456	9,529	8,642	8,715	7,281	41,809
	15,757	**22,711**	**17,278**	**24,448**	**17,680**	**15,581**	**113,457**
Financing Sources to be Applied							
Capital receipts	(4,298)	(4,260)	(5,125)	(1,700)	-	(6,281)	(21,663)
Grants & contributions	(63)	-	-	-	-	-	(63)
Revenue funding	(2,020)	(1,000)	(1,000)	(1,000)	(1,000)	(1,000)	(7,020)
	(6,380)	**(5,260)**	**(6,125)**	**(2,700)**	**(1,000)**	**(7,281)**	**(28,746)**
Minimum Revenue Provision							
Historic unfinanced borrowing	(500)	(500)	(500)	(500)	(500)	(500)	(3,000)
Current projects - long-life	(319)	(507)	(703)	(877)	(1,270)	(1,270)	(4,946)
Current projects - short-life	(14)	(277)	(1,652)	(2,249)	(3,111)	(3,111)	(10,413)
	(833)	**(1,284)**	**(2,855)**	**(3,626)**	**(4,881)**	**(4,881)**	**(18,359)**
Closing CFR	**25,572**	**41,739**	**50,038**	**68,160**	**79,959**	**83,378**	**83,378**

FINANCING COSTS	2023/24 £000	2024/25 £000	2025/26 £000	2026/27 £000	2027/28 £000	2028/29 £000	TOTAL £000
Minimum Revenue Provision (MRP)	833	1,284	2,855	3,626	4,881	4,881	18,359
Interest costs	50	529	922	1,434	1,821	1,954	6,710
Total revenue impact of borrowing	**883**	**1,813**	**3,777**	**5,060**	**6,702**	**6,835**	**25,069**

2.7 CIPFA's *Prudential Code for Capital Finance in Local Authorities* recommends that the PFCC's total external debt for the upcoming year should be lower than its CFR in the preceding year, as well as the CFR of both the current and next two years. Table 1 above and Table 2 below shows that the PFCC expects to comply with this requirement during 2024/25. This is demonstrated by Table 2 showing an expected requirement for external borrowing at 2024/25 year-end of £26.7m, which is lower than the highest forecast CFR of £68.2m (2026/27) across the specified four-year period.

2.8 The Table 2 model assumes assumptions for the Balance Sheet movement including a flat working capital surplus adjusted only for inflationary uplifts. It assumes a minimum cash requirement of £10m, based on this balance being deemed to be a fair approximation of what the PFCC would need to discharge its short-term cashflow commitments. Balance sheet resources also include general and earmarked reserves as well as capital receipts, with a profile based upon the current Medium-Term Financial Strategy (MTFS).

Table 2 – Liability Benchmark Summary

CAPITAL PROGRAMME - 2024/25 BUDGET SETTING LIABILITY BENCHMARK	2023/24 £000	2024/25 £000	2025/26 £000	2026/27 £000	2027/28 £000	2028/29 £000
Closing CFR	**25,572**	**41,739**	**50,038**	**68,160**	**79,959**	**83,378**
External borrowing (existing)	0	0	0	0	0	0
Internal financing	**25,572**	**41,739**	**50,038**	**68,160**	**79,959**	**83,378**
Balance sheet resources	(22,000)	(25,000)	(20,000)	(20,000)	(20,000)	(20,000)
Investments/(borrowing)	**(3,572)**	**(16,739)**	**(30,038)**	**(48,160)**	**(59,959)**	**(63,378)**
Treasury investments	10,000	10,000	10,000	10,000	10,000	10,000
New borrowing	**13,572**	**26,739**	**40,038**	**58,160**	**69,959**	**73,378**
Net loans requirement	3,572	16,739	30,038	48,160	59,959	63,378
Minimum short-term cashflow requirement	10,000	10,000	10,000	10,000	10,000	10,000
Cumulative liability/(asset) benchmark	**13,572**	**26,739**	**40,038**	**58,160**	**69,959**	**73,378**

ASSUMPTIONS	2023/24 £000	2024/25 £000	2025/26 £000	2026/27 £000	2027/28 £000	2028/29 £000
Capex increasing CFR	9,376	17,451	11,153	21,748	16,680	8,300
MRP on CFR	(833)	(1,284)	(2,855)	(3,626)	(4,881)	(4,881)
Change in balance sheet resources	-	(3,000)	5,000	-	-	-
Maturing loans	-	-	-	-	-	-
Net cash (inflow)/outflow	**8,543**	**13,167**	**13,298**	**18,122**	**11,799**	**3,419**

2.9 Table 2 demonstrates that the Liability Benchmark increases markedly from 2024/25 onwards as capital resources reduce. Whilst this model assumes no existing external borrowing for presentational purposes, this requirement is shown in the 'Investments/ (new borrowing)' line within the table, with £16.7m of gross external borrowing for capital purposes required by the end of 2024/25 to reduce the burden on the PFCC's internal cash balances. Extrapolating this requirement forward to the end of 2028/29 shows an expected total amount of £63.4m of forecast external debt to fund capital expenditure across this period. Any element of the CFR debt burden over and above these values will therefore be funded by internal borrowing.

2.10 It should also be noted that Table 2 sets out the minimum £10m amount of desired cash available which the PFCC requires to meet short-term cashflow commitments. Therefore, whilst capital-related external debt is forecast to be £16.7m by the end of 2024/25 this will actually be comprised of £26.7m external borrowing and £10m investments. Based upon applying a similar composition across all of the years in the current MTFS period the gross external debt is therefore actually forecast to be £73.4m.

2.11 The cost of borrowing for the capital programme relates to two elements, Minimum Revenue Provision (MRP) and the cost of debt interest. MRP is based on the asset life of the projects which need to be financed and is the material element of the cost of borrowing, with costs increasing from £0.8m in 2023/24 to £4.9m per annum in 2028/29 (Table 2, assumptions). Please refer to the PFCC's Capital Strategy for further detail on the subject of MRP. The debt interest element is also included within Table 1 and based on current interest rates as well as the medium-term outlook for where rates will potentially go over the next few years, this impact is also expected to be material with the annual value rising to £2.0m per annum by 2028/29, and a total cost of £6.7m across the current MTFS period. Please refer to the Borrowing Strategy (section 3) for further detail on these costs, as well as Table 4 below.

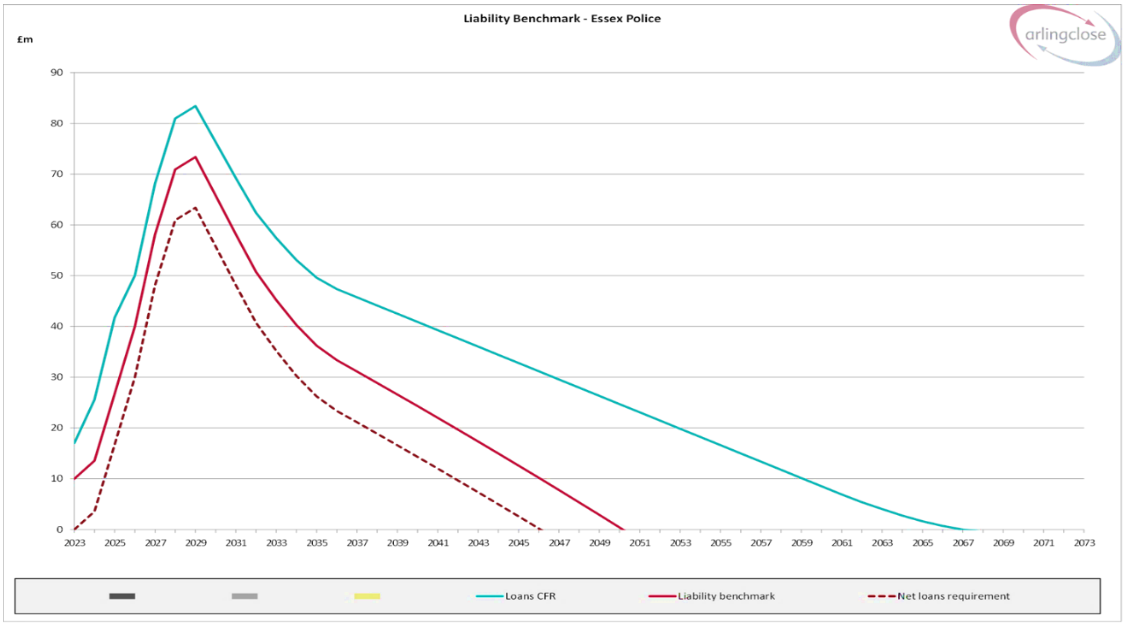
2.12 Following on from the medium-term forecasts within Table 2, a long-term liability benchmark has been created in Table 3 below, which forecasts the PFCC's need to borrow over a 50-year period. This assumes the following from 2029/30 onwards:

- Estimated debt-funded capital expenditure for the years 2029/30 – 2033/34 based on rolling programme costs as well as estimates for limited further investment in the main portfolio areas
- No further debt funded capital expenditure beyond 2033/34
- Minimum revenue provision on new capital expenditure based on the asset life method (charged to the Council Tax requirement one year in arrears)
- Income, expenditure, and reserves increasing by 2.5% inflation a year

2.13 The chart below directly links to Table 2 in respect of the trends shown. For the 'Loans CFR' line this shows the CFR peaking at just over £83.4m around 2028/29. From that point onwards the CFR steadily decreases with short-term projects prioritised for financing by existing resources, and property-based spend being allocated to borrowing and being repaid over 40 years.

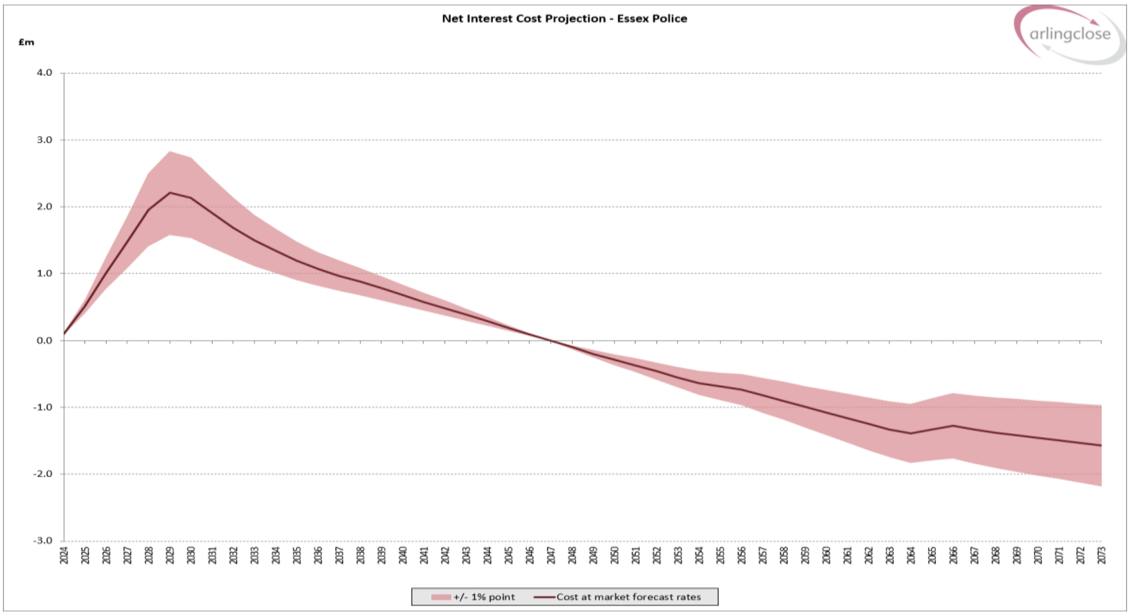
2.14 Whilst the trend described above gives a potential estimate of the longer-term CFR it should be noted that slippages to the capital programme will most likely change this profile. In addition, the model assumes no further debt-funded capital spend beyond 2033/34, an approach which is in accordance with the 2021 Prudential Code.

Table 3 – Liability Benchmark Chart



2.15 Based on an assessment of the interest rate outlook across the same period as the long-term liability benchmark period shown in Table 3, the PFCC has also assessed its projected debt interest costs across the longer term, using a projected variable range of +/- 1% to estimate the impacts/sensitivity of potential interest rate movements compared to the underlying assumptions used. The results are summarised within Table 4 below.

Table 4 – Net Interest Cost Projection Chart



3.0 Borrowing Strategy

3.1 The PFCC currently has no external borrowing but, as per paragraph 2.9, expects to borrow circa £73.4m for the period up to 2028/29 based on the current capital programme projections, which will be sourced in accordance with the PFCC's authorised limit of (external) borrowing and agreed governance arrangements. In 2024/25 the requirement is expected to be approximately £26.7m (including the funds required to discharge short-term cashflow commitments).

3.2 The PFCC's chief objective when borrowing money is 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. Given the significant cuts to local government funding, the PFCC'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 continuing to be much lower than long-term rates, it is likely to be more cost-effective in the short-term to either use internal resources, or to borrow short-term loans instead. By doing so, the PFCC is able to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk.

3.3 The main route of local government borrowing is typically via HM Treasury via the Public Works Loan Board (PWLB). However, with PWLB rates typically not the most attractive option in the marketplace, the PFCC will actively look to borrow from other sources including banks and other local authorities in order to lower interest costs and reduce over-reliance on one source of funding in line with the CIPFA Code.

3.4 The 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 lends 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 PFCC.

3.5 Variable-rate loans leave the PFCC exposed to the risk of interest rate rises and are therefore subject to the interest rate exposure limits in the treasury management indicators set out elsewhere in this report. Net exposure to interest rates will be monitored and managed to ensure a change in interest rates does not lead to an unbudgeted burden. The PFCC plans to undertake the majority of its underlying net borrowing on a fixed rate basis, but short-term variable rates will be considered.

3.6 Should the economic position be favourable, the PFCC may seek to arrange starting loans during 2024/25, 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 the cost of carry in the intervening period. However, based upon the current advice from the PFCC's treasury advisors Arlingclose it is not anticipated that this is a recommended option at the current time, with rates expected to steadily decrease after 2024/25.

3.7 The PFCC may also use short-term loans to cover unplanned cash flow shortages and its liquidity position, in addition to its existing bank overdraft facilities. These amounts will typically be excluded from the trends and values presented in Tables 2 and 3 which show the external borrowing which is expected to be required to fund capital investment. In practice the actual amounts of external borrowing during the year may be higher than the values in Table 2 due to the number of instances where short-term external borrowing may be required to meet cashflow commitments.

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

- HM Treasury's PWLB lending facility (formerly the Public Works Loan Board)
- UK Infrastructure Bank Ltd
- Any institution approved for investments (see Investments Strategy section)
- 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 Essex LGPS)
- Capital market bond investors
- Retail investors via a regulated peer-to-peer platform
- UK Municipal Bonds Agency plc and other special purpose companies created to enable local authority bond issues

Proposed borrowing approach 2024/25

3.9 In all likelihood the PFCC will look to use either local authorities or the PWLB for its external borrowing requirement in 2024/25. Based on current market conditions the PFCC would propose to structure any borrowing over the short-term only which for all local authorities (including the PFCC) would mean an approximate rate of around 5.25%, equating to the current UK base rate. For comparison purposes the current PWLB 1 year certainty rate is currently 5.38% at the time of writing.

3.10 For the PWLB, options will be considered for EIP (equal instalment payments), maturity and annuity loans, whilst the term will be based on financial considerations (as stated above) as well as the useful economic lives of the assets being financed. The PFCC will continue to apply for the certainty rate, which discounts loans at 20 basis points if an organisation can demonstrate its solvency with a sound and viable Medium Term Financial Strategy (MTFS), which can support the request for borrowing. The PFCC's MTFS would be able to provide this assurance.

3.11 The PFCC has readily available access to the local authority markets for cash on a daily basis via its brokers, as well as related dealing portals. Whilst rates vary on a daily basis based on bids submitted the local authority cash market remains a key component of the PFCC's borrowing options. As well as local authorities and the PWLB the PFCC will continue to investigate other sources of finance, such as bank loans that may be available at more favourable rates.

3.12 The PFCC will not specifically undertake external borrowing to solely meet its £10m target minimum cashflow balance. Should the PFCC's cash position fall below £10m, external borrowing will only be undertaken once it has fallen into a deficit position, with any monies subsequently sourced ideally taking the PFCC's cash balance back up to the recommended £10m minimum level. This approach also links into the legislation requirements set out in paragraph 6.3.

3.13 Following discussion with the PFCC's treasury advisors the previous table listing specific thresholds for certain types of external borrowing has now been removed from the TMS for 2024/25. The reasoning for this is that as long the source of borrowing is sound and the funds are committed, there is no risk for the PFCC. It is therefore no longer proposed to list limits via the previous approach used, thus also providing more flexibility should this be required.

3.14 Going forward the PFCC will look at rescheduling its debt structure across subsequent years where appropriate, in order that the most viable financing plan is adopted. Should the PFCC be in a position where it has external borrowing it will look to repay loans before maturity, either paying a premium or receiving a discount based on interest rates at that point in time. This will be actioned where it is expected to lead to an overall cost saving or reduction in risk. Debt restructuring is currently allowed by the PWLB and other lenders may be prepared to negotiate on similar terms. The PFCC may take advantage of this and replace existing loans with new loans or simply repay existing loans. The recent rise in interest rates means that more favourable debt rescheduling opportunities should arise than in previous years.

Approval process for external borrowing

3.15 The PFCC is legally obliged to set affordable limits for external debt expected to be required during the year. Two limits are required – an 'authorised limit' which cannot be exceeded, and an 'operational boundary' which acts as a warning level should debt approach the 'authorised limit'. The limits for 2024/25 are included in the Capital Strategy and are based on the Capital Programme. However, whilst external borrowing will be restricted to the thresholds agreed (notably the 'authorised limit'), there are also additional approval processes depending on the value and duration of the proposed borrowing. This will allow the PFCC closer oversight of when deals are proposed, particularly in relation to any higher value/longer-term element.

3.16 Treasury performance is reported on a quarterly basis to the PFCC's Strategic Board, including a forecast for the next quarter which encompasses updated estimates for external borrowing, with a maximum value expected for the following quarter set out within each report. Where individual instances of external borrowing are either long-term (greater than one year) or short-term (less than one year) but exceeding either £5m in value or one month in duration, this will be approved by the PFCC advance via the submission of a decision report. This process will ensure that all forecast external borrowing is subject to further review in advance of actual deals.

3.17 In respect of any short-term borrowing which does not exceed either £5m in value or one month in duration, this will be retrospectively notified to the PFCC's Chief Financial Officer at the earliest opportunity. This borrowing will typically be required to cover cashflow-related deficits and is not classed as structured borrowing to support capital expenditure (see paragraph 3.7). Included in this category will also be the use of the PFCC's bank overdraft which is currently available up to £3m.

4.0 Investment Strategy

4.1 The PFCC holds significant invested funds, representing income received in advance of expenditure, as well as balances and reserves held.

4.2 The CIPFA Code requires the PFCC to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The PFCC's objective when investing is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and receiving unsuitably low investment income. The PFCC aims to be a responsible investor and will consider environmental, social and governance (ESG) issues.

4.3 In the past twelve months, the PFCC's investment balance has been in excess of £52m with a normal peak occurring in the summer following the receipt of the annual Police Officer Pension Top-Up Grant from the Home Office. In 2024/25 investment balances are forecast to reduce with an average breakeven cash/investments position for the majority of the first quarter (depending on the timing of forecast capital receipts and other income), supported by short-term cashflow-related external borrowing where required. Thereafter, cash balances will increase following receipt of the top-up grant, reducing again over the subsequent months and ultimately falling into a deficit position during early 2025, at which point the PFCC will most likely require the assistance of further externally sourced funding.

4.4 The PFCC's investment approach will continue to prioritise liquidity for the PFCC's cash flow whilst seeking to maximise returns with the majority of surplus funds in secure and highly liquid financial instruments over the coming twelve months. The main areas the PFCC will be focusing on will be money market funds (MMF's) and call accounts, as well as DMADF deposits, local authority deposits and treasury bills.

4.5 For 2024/25 the PFCC may invest its surplus funds with any of the counterparty types in Table 5 below, subject to the limits shown.

Table 5 – Investment limits 2024/25

Treasury investment counterparties and limits 2024/25	Maximum time limit	Counterparty limit £	Sector limit £
UK central government (including DMADF facility)	10 years	Unlimited	Unlimited
UK local authorities & other government entities	5 years	£5m	Unlimited
Secured investments - UK (between A and AAA) fixed	1 year	£5m	Unlimited
Secured investments - Non-UK (between A and AAA) fixed term-duration	6 mths	£5m	Unlimited
Lloyds Bank plc (operational bank account) where at least A	1 year	£2m	n/a
Lloyds Bank plc (operational bank account) where below A	Overnight	£1m	n/a
Banks, Building societies and registered providers - UK unsecured (between A and AAA) fixed term duration	1 year	£2m	Unlimited
Banks, Building societies and registered providers - Non-UK unsecured (between A and AAA) fixed term duration	6 mths	£2m	50%
Banks, Building societies and registered providers - unsecured (between A and AAA) with same day access e.g. call accounts	n/a	£5m	Unlimited
Money market funds (minimum AAA rated)	n/a	£5m	Unlimited
Strategic pooled funds	Separate approval to be sought from PFCC office		

Notes on investment limits:

- Following a review of these limits with the PFCC's treasury advisors, the limits for secured investments have been increased to £5m for the 2024/25 TMS (previously £2m)
- In relation to the PFCC's operational bank account with Lloyds, an exception applies where forecast cash outflows (e.g. salaries or supplier payments) necessitate additional funds being held for a specific short-term purpose. In these instances, a balance of up to £10m is permitted to be held overnight (e.g.one day's duration).
- The minimum credit ratings in Table 5 relate to the lowest published long-term credit ratings for the counterparty or instrument concerned. However, investment decisions are never solely based on credit ratings, and all other relevant factors including external advice will be considered.
- Where the PFCC has exposure to one counterparty in respect of both fixed-term/notice and callable deposits (e.g. Barclays) the PFCC will deduct any fixed-term limit value (e.g. the higher risk element) from the call account investment held, to ensure balances remain proportionate for exposure risk to individual counterparties.

4.6 In respect of MMF's which are set out in further detail in paragraph 4.13, the PFCC currently has five funds in which investments can be placed. It should be noted that MMF's are highly diversified funds with immediate access and competitive returns making these an attractive option for the PFCC, assuming they meet the AAA criteria set out in Table 5. In addition, as MMF's have same-day access like call accounts, funds can be withdrawn at short notice should any credit ratings change.

4.7 Investments will typically be made at a fixed rate of interest, or alternatively at a variable rate linked to a market interest rate, such as LIBOR, subject to the limits on interest rate exposure. Where balances are expected to be invested for more than one year, the PFCC 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. Based on the limits shown in Table 5 there will be no investments for a period of greater than one year in 2024/25.

Types of investments

4.8 **Government**: Loans, bonds and bills issued or guaranteed by the UK national government, 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 have zero credit risk due to the ability to create additional currency, and therefore unlimited investments may be made for up to 50 years.

4.9 **Secured investments:** Investments secured on the borrower's assets, which limits the potential losses in the event of insolvency. The amount and quality of the security will be a key factor in the investment decision. Covered bonds and reverse repurchase agreements with banks and building societies 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 and counterparty rating will be used. The combined secured and unsecured investments with any one counterparty will not exceed the cash limit for secured investments.

4.10 **Operational bank account:** The PFCC may incur operational exposure through the use of its own banking facilities, relating 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 in accordance with the criteria in Table 5. 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 PFCC maintaining operational continuity.

4.11 **Banks & building societies (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.

4.12 **Registered Providers (unsecured):** Loans and bonds issued or guaranteed by registered providers of social housing or registered social landlords (formerly housing associations). These bodies are tightly regulated by the Regulator of Social Housing (in England) and similar regulatory bodies across the UK. As providers of public services, they retain the likelihood of receiving government support if needed.

4.13 **Money market funds (MMF's):** Pooled funds that offer same-day or short notice liquidity and very low or no price volatility by investing in short-term money markets. They have the advantage over bank accounts of providing wide diversification of investment risks, coupled with the services of a professional fund manager. Their returns are typically equivalent to, or higher than, short-term fixed-term deposits with UK banks. Whilst the investment guidance for MMF's is set out in Table 5 the guideline exposure for these funds will also incorporate the following:

1) Investment exposure of no more than 0.5% of the total MMF (if a government MMF then this can be 2%).

2) Investment exposure is diversified, as far as practical, over multiple MMF's, with broadly equal exposure to each fund, with no more than 50% of total investments held in one MMF at any time, and a guideline per fund maximum balance in the region of 10% of total investments held at any time.

3) Assuming condition 1) is initially met, investments in each MMF are limited to £5m of total investments held at any time.

4.14 **Strategic pooled funds:** Bond, equity and property funds that offer enhanced returns over the longer term but are more volatile in the short term. These allow the PFCC 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, they are typically used as a long-term investment instrument.

4.15 Referring to the content in the last couple of TMS documents, and again noting that economic conditions would need to be favourable, a proposal for a strategic pooled fund will continue to be explored with the goal of achieving longer-term returns for the PFCC and taking advantage of the more robust interest rate environment. This diversification into higher yielding asset classes, would encompass an amount of money ring-fenced for longer-term investment into a pooled fund on the understanding that such an investment approach will not unduly impact on the wider TMS priorities, and the strategic pooled fund in question meets the approved criteria as set out within this strategy. The resulting returns from such a fund would also potentially assist with meeting the financing costs of the PFCC's capital investment programme. A 'per fund' limit of £5m is proposed, with the total sector limit for these types of investments also set at £5m with such limits allowing the PFCC to enter this market without being over-exposed, thereby ensuring that the related risks and structure of these instruments can be understood in more detail, prior to further investments being made.

4.16 Should the strategic pooled fund proposal be subsequently approved this would mean that an additional £5m of external borrowing would be required to provide the surplus funds for these investments. This external borrowing would be *in addition to* the values set out in Table 2. Under current CIPFA guidance it is understood that it is acceptable to externally borrow for the purpose of investing in strategic pooled funds, however based on prudence it is proposed that additional assurance is obtained to verify this understanding should this proposal be progressed.

4.17 **Other investments:** This category covers treasury investments not listed above, for example real estate investment trusts, unsecured corporate bonds, and company loans. Non-bank companies cannot be bailed-in but can become insolvent placing the PFCC's investment at risk.

4.18 **Risk assessment and credit ratings**: Credit ratings are obtained and monitored by the PFCC's treasury advisors, who will notify changes in ratings as they occur. Investments limits are set by reference to the lowest published long-term credit rating from a selection of external rating agencies (mainly Fitch, Moody's, or Standard & Poor's). Where an entity has its credit rating downgraded so that it fails to meet the approved investment criteria set out in Table 5 then:

- No new investments will be made
- Any existing investments that can be recalled or sold at no cost will be
- Full consideration will be given to the recall or sale of all other existing investments with the affected counterparty

4.19 Where a credit rating agency announces that a credit rating is on review for possible downgrade (also known as 'rating watch negative' or 'credit 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.

4.20 **Counterparty exposure:** A group of entities under the same ownership will be treated as a single organisation when reviewing counterparty limits and criteria. In addition, any balances held in the PFCC's operational bank accounts will be included in the calculation of exposure to that entity, as well as any investments. In respect of exposure to counterparties where the PFCC holds multiple types of investment, please see paragraph 4.6.

4.21 **Other Information on the Security of Investments**: The PFCC 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 PFCC's treasury management advisors. 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.

4.22 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 PFCC 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 financial institutions of high credit quality are available to invest the PFCC's cash balances, then the surplus will be deposited with the UK Government, via the Debt Management Office for example, or with other local authorities. This will cause investment returns to fall but will protect the principal sum invested.

4.23 **Liquidity management:** The PFCC uses an internally created cashflow forecasting process to determine the maximum period for which funds may prudently be committed. The forecast is compiled on a prudent basis to minimise the risk of the PFCC being forced to borrow on unfavourable terms to meet its financial commitments. The PFCC will typically look to spread its liquid cash over several call accounts and MMF's to ensure that access to cash is maintained in the event of operational difficulties for any one provider. Limits on long-term investments are set by reference to both the criteria in Table 5 as well as the PFCC's MTFS.

4.24 **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 and therefore the PFCC's ESG policy does not currently include ESG scoring or other real-time ESG criteria at an individual investment level. When investing in banks and funds, the PFCC will try to 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. However, the limited counterparties available to invest with for the PFCC as well the competing issues of yield, security, and liquidity, may mean this is not always achievable.

5.0 Treasury Management Indicators

5.1 The PFCC measures and manages its exposure to treasury management risks using the following indicators.

5.2 **Interest rate exposures**: These indicators are set to control the PFCC's exposure to interest rate movements, and place limits on the total amount of risk the PFCC is exposed to. The one-year impact indicator calculates the theoretical impact on the revenue account of a 1% movement in all interest rates over the duration of one financial year, with the results shown below in Table 6.

Table 6 – Interest Rate Risk Indicator

Interest rate risk indicator	Limit
Upper limit on one year revenue impact of a 1% rise in interest rates – (surplus)/deficit	(£100,000)
Upper limit on one year revenue impact of a 1% fall in interest rates – (surplus)/deficit	£100,000

5.3 The above figures reflect the potential impact of a rise or decrease in the current base rate of 5.25% to either 6.25% or down to 4.25%. The figures shown are the estimated net impact on investments and borrowing in each instance. In the event of a 1% increase, investments would increase but anticipated borrowing costs would rise. Conversely, a 1% decrease would mean further negative returns on investments but potentially an opportunity to access cheaper borrowing. The impact of a change in interest rates is calculated on the assumption that maturing loans and investments will be replaced at current rates.

5.4 **Security:** The PFCC has adopted a voluntary measure of its exposure to credit risk by using minimum credit rating criteria for the counterparties it invests money with. This data is reviewed within monthly reports from Arlingclose, with daily updates received as and when there are significant credit rating changes for a counterparty. Table 7 below reflects the minimum credit rating adopted by the PFCC, with further detail of this process also covered within paragraphs 4.18 and 4.19.

Table 7 – Security

	Target
Minimum credit rating *(excluding operational bank account but only where short-term cashflow requirements demand this, or whilst actively seeking other banking arrangements – see Table 5, para 4.6)*	A

5.5 **Liquidity:** The PFCC has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments on a daily basis, without the need for additional borrowing. The net overdraft facility with Lloyds Bank is currently £3m to cover short term cash requirements on the basis this deficit does not exceed 2-3 working days, thus assisting with cashflow management.

It should also be noted that the PFCC treats the bank overdraft as part of its short-term borrowing in respect of approval/governance processes.

Table 8 – Liquidity #1

	Target
Gross bank account overdraft facility available	£10m
Net bank account overdraft facility available	£3m

5.6 In addition, the PFCC will look to keep a minimum amount of money in call accounts and MMF's to ensure it is fully able to meet unforeseen commitments as they arise.

Table 9 – Liquidity #2

	Target
Minimum amount of investment portfolio held in call accounts and money market funds	Lower of £10m or 50% of total investments

5.7 **Principal sums invested in fixed-term deposits for periods longer than a year:** The purpose of this indicator is to control the PFCC's exposure to the risk of incurring losses by seeking early repayment of its investments. Based on current economic conditions and noting that the strategic pooled fund proposal is not yet approved, Table 10 below confirms that it is not proposed that the PFCC will enter into any fixed-term investments beyond 365 days in the immediate future, apart from investments with central or local government entities.

Table 10 – Fixed-term investments longer than 1 year in duration

	2024/25	2025/26	2026/27
Limit on principal invested beyond one year (non-government)	£0m	£0m	£0m

5.8 **Maturity structure of borrowing:** This indicator is set to control the PFCC's exposure to refinancing risk. The upper and lower limits on the maturity structure of borrowing in 2024/25 are set out in Table 11 below.

Table 11 – Maturity structure of borrowing

Refinancing rate risk indicator	Upper limit	Lower limit
Under 12 months	100%	0%
12 months and within 24 months	50%	0%
24 months and within 5 years	25%	0%
5 years and within 10 years	25%	0%
10 years and above	25%	0%

6.0 Other Items

6.1 The CIPFA Code requires the PFCC to include the following in its TMS:

6.2 **Financial Derivatives:** In the absence of any explicit legal power to do so, the PFCC will not use standalone financial derivatives (such as swaps, forwards, futures and options). Derivatives 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.

6.3 **Markets in Financial Instruments Directive (MiFID):** The PFCC has opted up to professional client status with its providers of financial services, including advisers, banks, brokers and fund managers, allowing it access to a greater range of services but without the greater regulatory protections afforded to individuals and small companies. Given the size and range of the PFCC's treasury management activities, the Chief Financial Officer believes this to be the most appropriate status. As part of the requirement to be become a professional client, the PFCC is required to demonstrate that a £10m minimum cash and investments balance is available throughout the year. To meet this legislation, the PFCC ensures its average balance across the year is equal to or exceeds £10m, thus demonstrating compliance with this requirement.

6.4 **Third-party funds held:** The PFCC receives large sums of cash in relation to seizures from the Proceeds of Crime Act and the Police and Criminal Evidence Act. These monies are held for varying time periods before being either forfeited, confiscated or repaid to a third party. During 2023/24 these monies were co-mingled into the PFCC's bank accounts with interest calculated and added to any repayments to third parties. In respect of the annual statutory Statement of Accounts it should be noted that any seized funds held at the Balance Sheet date are removed from the cash and cash equivalents value reported, whilst any related interest repayable is also netted off the total investment income figure reported.

7.0 Financial implications

7.1 The budget for investment income in 2024/25 is £0.700m based on expected yield, balanced against the PFCC requirement to focus on liquidity and security of funds. The budget for debt interest payable in 2024/25 is £0.529m based on the estimated external borrowing requirement during the upcoming year.

7.2 If actual levels of investments and borrowing as well as interest rates differ from those forecast, performance against budget will be correspondingly different. It should also be noted that whilst interest rates have remained high during 2023/24, these are expected to reduce from the second quarter of 2024/25 onwards, and this impact has been reflected in the 2024/25 budget.

8.0 **Other options considered**

8.1 The CIPFA Code does not prescribe any particular treasury management strategy for public sector entities to adopt. The PFCC 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

Investment position as at 31st March 2023

	31/03/2023 £000	Start date	Maturity date	Approx. Rate %
Call/notice accounts				
Santander UK PLC	10			3.00%
Barclays Bank FIBCA	2,500			3.25%
Total	**2,510**			
Money market funds				
Insight	100			4.11%
Federated Hermes	1,000			4.09%
Aviva	500			4.11%
Total	**1,600**			
Other				
Lloyds current account	999			2.50%
	999			
Total treasury investments	**5,109**			

Investment position as at 29th February 2024

	29/02/2024 £000	Start date	Maturity date	Approx. Rate %
Call/notice accounts				
Santander UK PLC	10			4.75%
Barclays Bank FIBCA	2,500			4.25%
Total	**2,510**			
Money market funds				
Aberdeen	1,500			5.26%
Federated Hermes	5,000			5.29%
Aviva	4,000			5.27%
Total	**10,500**			
Other				
Lloyds current account	2,337			5.00%
	2,337			
Total treasury investments	**15,347**			

Appendix 2

Corporate Finance

(Commercial) Investment Strategy 2024/25

Meeting: 22nd April 2024

Date: 17th April 2024

Authors: Matthew Tokley / Arfanara Naidu

Investment Strategy 2024/25

1.0 Introduction

1.1. Local authorities (including police forces) invest their money for three purposes:

- Because it has surplus cash as a result of its day-to-day activities, for example when income is received in advance of expenditure (known as **treasury management investments**)

- To support local public services by lending to or buying shares in other organisations (**service investments**)

- To earn investment income (known as **commercial investments** where this is the main purpose, e.g. investment properties).

1.2. The Investment Strategy document was introduced in 2019/20, meeting the requirement of statutory guidance issued by the government in January 2018, and focuses on the second and third of the categories listed in paragraph 1.1.

1.3. For the forthcoming year the PFCC has decreed that service investments and commercial investments will not be used. Whilst this paper therefore satisfies the 2018 MHLG Investment Guidance it does not set out any detail or proposed approach in respect of these latter two types of investment. This approach is unchanged from the 2023/24 Investment Strategy.

1.4. The PFCC will continue to concentrate on treasury management investments during 2024/25.

2.0 Treasury Management Investments

2.1. The PFCC typically receives its income in cash (from taxes and grants) before it pays for its expenditure in cash (e.g. through payroll and invoices). It also holds reserves for future expenditure. These activities, plus any impact of borrowing decisions, lead to a cash surplus which is invested in accordance with guidance from the Chartered Institute of Public Finance and Accountancy (CIPFA).

2.2. The balance of cashflows are expected to fluctuate between up to £30m in deficit (prior to any external borrowing) and £50m in credit during 2024/25, depending on the period of the year.

2.3. **Contribution:** The contribution that these investments make to the objectives of the PFCC is to support effective treasury management activities.

2.4. **Further detail:** Full details of the PFCC’s policies and its plan for 2024/25 for treasury management investments are covered in a separate document, the Treasury Management Strategy (TMS).

3.0 Service Investments: Loans

3.1. **Contribution:** The PFCC has the option to lend money to support local public services and stimulate local economic growth.

3.2. Examples of who the PFCC could lend to for this purpose are listed below:

- Suppliers
- Local businesses
- Local charities
- Housing associations
- Local residents
- Employees

3.3. **Security**: The main risk when making service loans is that the borrower will be unable to repay the principal lent and/or the interest due. In order to limit this risk and ensure that total exposure to service loans remains proportionate to the size of the authority concerned, upper limits on the outstanding loans to each category of borrower will typically be set at the start of each financial year. Accounting standards also require any authority to set aside loss allowance for these loans, reflecting the likelihood of non-payment.

3.4. **Risk assessment:** In the event the PFCC enter into service loans with any of the above stakeholders a separate risk of loss will be calculated.

3.5. It is not anticipated that the PFCC will enter into any service loans during 2024/25 and therefore no borrowing limits or details of calculating the risk of loss for such loans have been included in this report.

4.0 Service Investments: Shares

4.1. **Contribution:** The PFCC has the option to invest in shares to support local public services and stimulate local economic growth.

4.2. Examples of who the PFCC could invest in for this purpose are listed below:

- Suppliers
- Local businesses

4.3. **Security**: One of the risks in investing in shares is that they fall in value meaning that the initial outlay may not be recovered. In order to limit this risk upper limits on the sum invested in each category of shares will typically be set at the start of each financial year.

4.4. **Risk assessment:** In the event the PFCC invest in shares with any of the above stakeholders a separate risk of loss will be calculated, including the maximum periods for which funds may prudently be committed.

4.5. It is not anticipated that the PFCC will undertake any service investments relating to shares during 2024/25 and therefore no investment limits or details of calculating the risk of loss for such investments have been included in this report. This includes any shares which meet the criteria of 'non-specified' investments in the government guidance.

5.0 Commercial Investments: Property

5.1. Contribution: The PFCC has the option to invest in property with the intention of making a profit that will be spent on operational policing.

5.2. **Security**: In accordance with government guidance the PFCC will consider a property investment to be secure if its accounting valuation is equivalent to, or is higher than, its purchase cost including taxes and transaction costs.

5.3. A fair value assessment of the PFCC's investment property portfolio will be made for the preceding twelve-month period at each year-end. The underlying assets provide security for investment.

5.4. Should the year-end accounts and audit process value these properties below their purchase cost, then an updated Investment Strategy would be presented to the PFCC detailing the impact of the loss on the security of investments and revenue consequences arising therefrom. Any mitigating actions which need to be taken to protect the capital invested will also be referenced in this report.

5.5. **Risk assessment:** The PFCC will assess the risk of loss before entering into and whilst holding any property investments.

5.6. **Liquidity:** Compared to other investment types, property is relatively difficult to sell and convert to cash at short notice and can take a considerable period to sell in certain market conditions. Where these investments are used assurance will need to be obtained to ensure that the invested funds can be accessed when they are needed, for example to repay capital borrowed.

5.7. It is not anticipated that the PFCC will undertake any commercial property investments during 2024/25 and therefore no detailed guidance in respect of how the risk of loss for such investments will be managed, have been included in this report.

6.0 Other Categories of Investment

6.1. **Loan Commitments and Financial Guarantees**: Although not strictly counted as investments, since no money has exchanged hands yet, loan commitments and financial guarantees carry similar risks to the PFCC and reference to these types of investment are included here for completeness.

6.2. **Borrowing in Advance of Need:** Government guidance states that the PFCC must not borrow more than or in advance of their needs purely in order to profit from the investment of the extra sums borrowed. Any future investment/borrowing options in respect of taking advantage of future interest rates forecasts will be discussed with the PFCC's advisors Arlingclose, to ensure compliance with regulations and that risk exposure is minimised. In respect of its upcoming external borrowing requirement across the medium-term the PFCC does not currently anticipate that borrowing in advance of need will provide any significant financial gain based on the interest rates forecast – see paragraph 3.6 of the TMS. In addition, the PFCC is currently considering borrowing for the purposes of investing in a strategic pooled fund. Should this proposal progress, the PFCC will seek further guidance to ensure compliance. However, it should be noted that any such borrowing will still be fundamentally for the purposes of capital expenditure, whilst still allowing the PFCC to pursue investment opportunities and an income yield over the medium-term. Further details of this proposal are set out in the TMS.

7.0 Capacity, Skills and Culture

7.1. Decision-making in respect of cashflow forecasting, investments and borrowing has been delegated by the PFCC to the Corporate Finance Team who undertake daily processes and periodically report to the PFCC's Chief Financial Officer, both in respect of retrospective performance and forward-looking plans. The Chief Accountant will prepare an annual TMS, (Commercial) Investment Strategy and Capital Strategy at the start of each year. Quarterly reports mainly covering cashflow performance will be prepared during the year followed by an outturn performance report each May. All the above papers will be submitted to boards administered by the PFCC, with final approval/sign-off by the PFCC in each instance.

8.0 Investment Indicators

8.1. Where the PFCC chooses to use a range of investments (as those shown in paragraphs 3 – 6) in addition to its treasury management investments, a range of quantitative indicators will typically be used to allow the PFCC and the public to assess the PFCC's total risk exposure as a result of its investment decisions and financial instruments portfolio.

8.2 As the PFCC does not currently plan to be involved in any service investments or place any commercial investments during 2024/25, no separate indicators are included in this report and all related aspects of risk management for treasury activity, and associated indicators, are included instead within the separate TMS.

Appendix 3

Corporate Finance

Capital Strategy 2024/25

Meeting: 22nd April 2024

Date: 17th April 2024

Author: Matthew Tokley

Capital Strategy 2024/25

1.0 Introduction

1.1 The PFCC has adopted the Chartered Institute of Public Finance and Accountancy's *Prudential Code of Practice in the Public Services*, which requires the PFCC to approve a capital strategy before the start of each financial year.

1.2 The Prudential Code provides a clear set of objectives and a framework within statutory legislation that proposes new capital expenditure to be evaluated to ensure that all new capital investment is targeted at meeting the pledges within the PFCC's vision, aims and priorities.

1.3 The Capital Strategy gives a high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of local public services along with an overview of how associated risk is managed and the implications for future financial sustainability. It has been written in an accessible style to enhance the reader's understanding of these sometimes technical areas.

1.4 Decisions made this year on capital and treasury management will have financial consequences for the PFCC for many years into the future. They are therefore subject to both a national regulatory framework and to local policy framework, summarised in this report.

1.5 The strategy has direct links to the other management plans such as the Estates Strategy, IT Strategy and the Treasury Management Strategy (TMS) and also links into the Medium-Term Financial Strategy (MTFS).

2.0 Capital Expenditure and Financing

2.1 Capital expenditure is where the PFCC spends money on assets, such as property or vehicles, that will be used for more than one year. In local government this includes spending on assets owned by other bodies, and loans and grants to other bodies enabling them to buy assets. The PFCC has some limited discretion on what counts as capital expenditure, for example assets costing below £10,000 are not normally capitalised as deemed below 'de minimis' and are charged to revenue in year. However, there are some caveats to this guidance such as vehicles (where the threshold is lower) and where multiple amounts of the same asset equates to a total value over £10,000 (capitalisation 'by aggregation').

2.2 For further details of the PFCC's capitalisation approach reference should be made to the accounting policies section in the most recently published version of the Essex/PFCC Group Statement of Accounts, as well as the financial regulations, both of which are available to view on the PFCC's website.

2.3 For 2023/24 and the subsequent five-year period the PFCC is planning to spend a total of £113m on capital investment, including £23m in 2024/25. This is summarised in Table 1 below. It should be noted that the Capital Strategy (as with the TMS) is based on 2024/25 budget setting information.

Table 1 – Prudential Indicator: Estimates of Capital Expenditure

CAPITAL PROGRAMME - 2024/25 BUDGET SETTING EXPENDITURE SUMMARY	2023/24 £000	2024/25 £000	2025/26 £000	2026/27 £000	2027/28 £000	2028/29 £000	TOTAL £000
Capital Expenditure							
ANPR	115	120	120	120	120	120	715
Estates Business as Usual	2,139	1,425	1,300	1,300	1,300	1,300	8,764
Estates Strategy	5,403	6,396	5,678	14,413	7,665	7,000	46,555
I.T. Services	3,309	11,083	5,599	4,496	4,414	3,467	32,368
OPC	501	-	-	-	-	-	501
Other	761	528	500	500	500	250	3,039
SCD	92	-	-	-	-	-	92
Transport	3,439	3,159	4,081	3,619	3,681	3,444	21,423
	15,757	**22,711**	**17,278**	**24,448**	**17,680**	**15,581**	**113,457**

2.4 There are four main areas of spend which feature within the Capital Programme: Estates Strategy, Estates Business as Usual, Transport and Information Technology. These support the vision and strategic priorities for the PFCC as highlighted in the Police and Crime Plan.

2.5 The main element of spend relates to Estates, with £9m of forecast spend relating to work to improve existing assets and a further £47m relating to the Estates Strategy. Together these elements equate to nearly 50% of the overall spend across the term. The principal objective of the Estates Strategy is to streamline the PFCC's property assets in line with policing demand in the 21st century, including modern infrastructure, technological advances as well as to support more adequate agile working across the force. A key part of this project is to significantly redevelop and modernise the force HQ site in Chelmsford, with an ongoing review underway to agree the way forward on this major project. The other main area of spend relates to I.T. Services with nearly £33m of spend forecast over the six years, relating to a wide range of national and locally led projects with the overriding objective to provide more efficient digital solutions for all aspects of operational policing and their support services, and to fully utilise SharePoint and Office 365 technology across the force.

2.6 All capital expenditure must be financed, either from external sources (such as grants and contributions), the PFCC's own resources (revenue reserves or capital receipts) or debt (borrowing).

2.7 Debt is only a temporary source of finance, since loans must be repaid, and this is therefore replaced over time by other financing, usually from revenue which is known as minimum revenue provision (MRP). Alternatively, proceeds from selling assets (known as capital receipts) may be used to replace debt finance. The planned financing plan in Table 1 (including any forecast debt) is set out in Table 2.

Table 2 – Capital Financing

CAPITAL PROGRAMME - 2024/25 BUDGET SETTING FINANCING SUMMARY	2023/24	2024/25	2025/26	2026/27	2027/28	2028/29	TOTAL
	£000	£000	£000	£000	£000	£000	£000
Financing Sources to be Applied							
Capital receipts	(4,298)	(4,260)	(5,125)	(1,700)	-	(6,281)	(21,664)
Grants & contributions	(63)	-	-	-	-	-	(63)
Revenue funding	(2,020)	(1,000)	(1,000)	(1,000)	(1,000)	(1,000)	(7,020)
Borrowing	(9,377)	(17,451)	(11,153)	(21,748)	(16,680)	(8,300)	(84,709)
	(15,757)	**(22,711)**	**(17,278)**	**(24,448)**	**(17,680)**	**(15,581)**	**(113,457)**

2.8 The PFCC's cumulative outstanding amount of debt finance is measured by the Capital Financing Requirement (CFR). This increases with new debt-financed capital expenditure and reduces with MRP/loan fund repayments, and capital receipts where used to replace debt. The CFR is expected to increase to a value in excess of £41m by the end of 2024/25. The PFCC's estimated CFR is as follows:

Table 3 – Prudential Indicator: Estimates of CFR

CAPITAL PROGRAMME - 2024/25 BUDGET SETTING CAPITAL FINANCING REQUIREMENT (CFR) SUMMARY	2023/24	2024/25	2025/26	2026/27	2027/28	2028/29	TOTAL
	£000	£000	£000	£000	£000	£000	£000
Opening CFR	**17,028**	**25,572**	**41,739**	**50,037**	**68,160**	**79,959**	**17,028**
Capital Expenditure	15,757	22,711	17,278	24,448	17,680	15,581	**113,457**
Financing for expenditure not supported by borrowing	(6,380)	(5,260)	(6,125)	(2,700)	(1,000)	(7,281)	**(28,746)**
Minimum Revenue Provision	(833)	(1,284)	(2,855)	(3,626)	(4,881)	(4,881)	**(18,359)**
Closing CFR	**25,572**	**41,739**	**50,037**	**68,160**	**79,959**	**83,378**	**83,378**

2.9 **Asset Management**: To ensure that capital assets continue to be of long-term use, the PFCC has an asset management strategy in place. This is known as the Estates Strategy, the latest copy of which can be found on the PFCC website.

2.10 **Asset Disposals**: When a capital asset is no longer needed, it may be sold so that capital receipts, can be spent on new assets or to repay debt. Repayments of capital grants, loans and investments also generate capital receipts. The PFCC is forecasting to receive in excess of £33m over the medium-term period, with £4.3m of receipts expected in 2024/25. The main receipts expected during the medium-term period set out below are disposals of land in relation to the force HQ project.

Table 4 – Capital receipts receivable

CAPITAL PROGRAMME - 2024/25 BUDGET SETTING CAPITAL RECEIPTS SUMMARY	2023/24 £000	2024/25 £000	2025/26 £000	2026/27 £000	2027/28 £000	2028/29 £000	TOTAL £000
Opening balance	-	-	-	-	-	-	-
Received	(4,298)	(4,260)	(5,125)	(1,700)	-	(18,000)	**(33,383)**
Applied for financing	4,298	4,260	5,125	1,700	-	6,281	**21,664**
Closing balance	-	-	-	-	-	**(11,720)**	**(11,720)**

2.11 The government has issued statutory guidance on the flexible use of capital receipts, which has now been extended for a further three years up until 31st March 2025. This enables the PFCC to use capital receipts in year to finance individual projects that would otherwise be a charge to the revenue account. However, at the current point in time the PFCC does not anticipate taking advantage of this financing option on the basis that all capital receipts need to be retained for subsequent years capital expenditure. It is therefore unlikely that the PFCC will be in a position to take advantage of this approach before this flexibility is withdrawn at the end of 2024/25.

3.0 Treasury Management

3.1 Treasury management is concerned with keeping sufficient but not excessive cash available to meet the PFCC's spending needs, while managing the risks involved. Surplus cash is invested until required, while a shortage of cash will be met by borrowing, to avoid excessive credit balances or overdrafts in the bank current account. The PFCC is typically cash rich in the short-term as revenue income is received before it is spent, but cash poor in the long-term as capital expenditure is incurred before being financed. The revenue cash surpluses are offset against capital cash shortfalls to reduce overall borrowing (aka 'internal borrowing').

3.2 When borrowing the PFCC must demonstrate compliance with the Prudential Code making sure that it is affordable, prudent, and sustainable. To meet this requirement the PFCC aims to achieve a low but certain cost of finance whilst retaining flexibility should plans change in future. These objectives are often conflicting, and the PFCC therefore seeks to strike a balance between short-term loans and longer-term fixed rate loans which, whilst providing budgetary stability, are typically more expensive.

3.3 Projected levels of the PFCC's total forecast debt are shown in the table below.

Table 5 – Prudential Indicator – Gross Debt and the CFR

CAPITAL PROGRAMME - 2024/25 BUDGET SETTING GROSS DEBT AND THE CFR	2023/24 £000	2024/25 £000	2025/26 £000	2026/27 £000	2027/28 £000	2028/29 £000
Gross Debt (External Borrowing)	13,572	26,739	40,038	58,160	69,959	73,378
CFR (Total Debt)	25,572	41,739	50,038	68,160	79,959	83,378

3.4 Statutory guidance recommends that the PFCC's total external debt should remain below the CFR, except in the short-term where required. Table 5 above shows that the PFCC expects to comply with this requirement in the medium-term.

3.5 **Liability benchmark**: To estimate the PFCC's actual external debt over the medium-term period, a liability benchmark has been calculated showing the lowest risk level of borrowing. This assumes that cash and investment balances are kept to a minimum level of £10m at each year-end, for liquidity purposes and compliance with MiFID II legislation. There is also a subsequent assumption that this balance of £10m will be required at all times in addition to any capital-specific requirement. Because the PFCC uses the liability benchmark tool to estimate its external borrowing requirements these figures are the same as those set out in Table 5 above. The detail of these calculations is presented within the PFCC's TMS.

3.6 **Affordable borrowing limit**: The PFCC is legally obliged to set an affordable borrowing limit (also termed the authorised limit for external debt) each year. A lower 'operational boundary' is also set as a warning level should debt approach the affordable borrowing limit. As these thresholds cannot be breached, any subsequent requirement to extend these limits would require separate approval from the PFCC, with this request submitted as soon as practically possible once the operational boundary has been exceeded. The previously reported limits for the current year as well as the revised/proposed limits for the next three years are shown below.

Table 6 – Prudential Indicator – Authorised Limit and Operational Boundary for External Debt

CAPITAL STRATEGY 2024/25 AUTHORISED LIMIT AND OPERATIONAL BOUNDARY	2023/24 £000	2024/25 £000	2025/26 £000	2026/27 £000
Authorised Limit (Total External Debt)	40,000	40,000	55,000	75,000
Operational Boundary (Total External Debt)	30,000	30,000	45,000	65,000

3.7 The above limits are based on forecast liability benchmark estimates included within the 2024/25 TMS, as well as cashflow-related borrowing requirements which may be required during each year, which may require higher amounts of external funding to be sourced than the forecast values for each year-end in the liability benchmark model.

3.8 As set out in the TMS, CIPFA's *Prudential Code for Capital Finance in Local Authorities* recommends that the PFCC's total external debt for the upcoming year should be lower than its CFR in the preceding year, as well as the CFR of both the current and next two years. The authorised limit of £40m for 2024/25 complies with this requirement by being less than the highest forecast CFR of £68m (2026/27) across the specified period.

3.9 Whilst the PFCC has set the above limits in accordance with its external debt expectations over the medium-term and to comply with the Prudential Code, additional arrangements have been introduced which requires additional approval for specific instances of external borrowing, based on the value and term involved. For further information please refer to section 3 of the TMS.

3.10 **Treasury investment strategy**: Treasury investments arise from receiving cash before it is paid out again. Investments made for service reasons or for pure financial gain are not generally considered to be part of treasury management.

3.11 The PFCC's policy on treasury investments is to prioritise security and liquidity over yield, that is to focus on minimising risk rather than maximising returns. Cash that is likely to be spent in the near term is invested securely, for example with the government or other local authorities, to minimise the risk of loss. Money held for longer terms is invested more widely, including in bonds, shares, and property, to balance the risk of loss against the risk of receiving returns below inflation. The PFCC's investments are typically held in short-term investments such as fixed term deposits, call accounts and money market funds, the latter two options for which the PFCC may request its money back at short notice.

3.12 **Risk management**: The effective management and control of risk are prime objectives of the PFCC's treasury management activities. The TMS therefore sets out various indicators and limits to constrain the risk of unexpected losses and details the extent to which financial derivatives are used to manage treasury risks.

4.0 <u>Governance</u>

4.1 **Capital Programme**: Where the expected capital spend is in excess of £50,000 budget holders submit new outline bids for projects on an annual basis for proposed inclusion in the following year's budget setting process. These are known as Stage B (formerly Stage 1) bids, and ringfence funding for the project concerned. Assumed the Stage B funding is approved, the next stage for each of these bids is a full Stage C (formerly Stage 2) business case which is then submitted to the PFCC for approval, prior to the green light being given to the project starting. A separate streamlined process operates in-year for capital spend below £50,000, with projects approved outside of the normal board process but still subject to a PFCC decision report. There is no requirement to bid for these monies at budget setting.

4.2 A new proposed governance framework to support the new templates has been put in place to support the processes set above, and in accordance with financial regulations this ensures that available resources are allocated optimally and deliver value for money, and that capital programme planning is determined in parallel with the service and revenue budget planning process within the framework of the MTFS.

4.3 As at February 2024 a proposal is currently being discussed with the PFCC office whereby instances of capital expenditure up to a maximum of £250,000 will no longer require PFCC approval and will instead be approved solely via the Chief Constable via either delegated authority (up to £50,000) or COG (up to £250,000). These proposals are subject to a further review of the current financial regulations and constitution on the basis that require further amendments to these documents may be required before these changes can be implemented. Should these proposals proceed during 2024/25 the revised approval processes will be included in more detail in the next version of the Capital Strategy.

4.4 Based on the existing process as at February 2024 the relevant boards that oversee the approval of capital business cases and the annual budget are as follows:

- The PFCC Performance and Resources Board which is responsible for reviewing capital and revenue budget monitoring reports and scrutinising MTFS documents.

- The PFCC Strategic Board which is responsible for recommending the approval of the Capital Strategy and the five-year capital programme, changes to the programme within financial regulations and for the approval of final business cases (Stage C). Subsequent decision sheets submitted are signed off, representing the formal approval stage (with the Stage A business cases signed-off separately as mentioned above).

- The Police, Fire and Crime Panel, who provide final oversight of the capital programme and MTFS as part of the formal budget setting process when the annual council tax precept is approved (the 2024/25 precept was approved on 1st February 2024).

4.4 The recent changes to the capital business cases process have resulted in new templates being produced in accordance with the HM Treasury guidance, moving closer towards the approach taken nationally across the public sector. This work has placed more emphasis on scrutinising higher value and complex projects rather than a one size fits all approach which was previously adopted. As mentioned in paragraph 4.3 some further changes to the governance process are currently being reviewed and should these proceed, some further amendments may be required to these existing templates during 2024/25.

4.5 Further governance is in place to ensure that there is an integrated approach to addressing cross-cutting issues and developing/improving service delivery through its capital investment, in pursuance of the PFCC's over-arching aims. These include:

- The Capital Management Board which has overall responsibility for the management of the capital programme and meets on a quarterly basis to review and scrutinise progress on projects and hold the related stakeholders to account. Whilst not a decision-making board, the attendees include the main capital budget holders, representatives of Corporate Finance and the PFCC, and contribute to an effective oversight/scrutiny process for the Capital Programme, as well as ensuring value for money.

- The Estates Change Board and IT Technology Prioritisation/Digital Transformation Boards which have overall responsibility for the strategic review of Estates and IT projects respectively

- The Strategic Change and Co-ordination Board which provides an initial strategic review for all projects which do not relate to Estates or IT

- Specific Project boards with key stakeholders which are set up to manage and progress projects and identify risks which could affect the project or PFCC entity

4.6 **Treasury processes**: Decisions on treasury management investment and borrowing are made daily by Corporate Finance staff in accordance with a monthly plan which is shared with the PFCC's Chief Financial Officer. Furthermore, quarterly reports are also provided to the PFCC office which provide an analysis of cashflow and treasury performance over the preceding quarter, as well as a high level cashflow forecast for the remainder of the year. Any decision making in respect of treasury management processes will always be consistent with the parameters and criteria of the TMS for that year, and approval for any proposed deviations from that strategy will need to be signed off by the PFCC in advance. Any such proposals will usually take the form of a recommendation within the quarterly Treasury Management performance reports.

5.0 Liabilities

5.1 In addition to the debt referred to earlier in this paper, the PFCC is committed to future payments to cover its net pension fund deficit for Police Officer and Police Staff schemes (valued at £2,114m as of the 31st of March 2023, based on the most recent (2022/23) PFCC/Group unaudited Statement of Accounts which can be found on the PFCC website). The PFCC has also set aside significant funds in provisions and reserves for various purposes, also referred to within the PFCC/Group Statement of Accounts. The PFCC is also at risk of having to pay for some of the contingent liabilities which it has disclosed, and some funds have been set aside for these during 2023/24 based on best estimates of potential liabilities.

5.2 Decisions on incurring new discretional liabilities are taken by Heads of Department in consultation with the Chief Finance Officers of the Chief Constable, and the PFCC. The risk of liabilities crystallising and requiring payment is monitored by Corporate Finance and reported quarterly to the Chief Constable and the PFCC during the year, within the budget monitoring reporting process.

6.0 Revenue Budget Implications

6.1 Although capital expenditure is not charged directly to the revenue budget, interest payable on loans and MRP is charged to revenue, offset by any investment income receivable. The net annual charge is known as financing costs; this is compared to the net revenue stream e.g., the budget requirement for the PFCC (the amount funded from Council Tax and general government grants). The ratios for the previous, current, and subsequent three years are shown in Table 7 below.

Table 7 – Prudential Indicator: Proportion of financing costs to net revenue stream

CAPITAL STRATEGY 2024/25 FINANCING COSTS PROPORTION OF NET REVENUE STREAM	2023/24 £000	2024/25 £000	2025/26 £000	2026/27 £000	2027/28 £000	2028/29 £000
Minimum Revenue Provision (MRP)	833	1,284	2,855	3,626	4,881	4,881
Interest payable	50	529	922	1,434	1,821	1,954
Interest receivable	(1,100)	(700)	(500)	(250)	(200)	(200)
Net financing costs	**(217)**	**1,113**	**3,277**	**4,810**	**6,502**	**6,635**
Net revenue stream	363,684	385,538	391,024	397,057	403,302	409,768
Proportion of net revenue stream	**-0.06%**	**0.29%**	**0.84%**	**1.21%**	**1.61%**	**1.62%**

6.2 **Sustainability:** Due to the very long-term nature of capital expenditure and financing, the revenue implications of expenditure incurred in the next few years will extend up to 40 years into the future, based on long-life spend relating to Estates projects. The PFCC's Chief Financial Officer is satisfied that the proposed capital programme is prudent, affordable, and sustainable based on a detailed examination of the capital programme and the proposed financing plan, during the 2023/24 budget setting process. In particular, the MRP costs arising have been reviewed, and are in accordance with the MRP Policy Statement set out in Section 7.

7.0 <u>Minimum Revenue Provision (MRP) Policy Statement</u>

7.1 Where the PFCC finances capital expenditure by debt, it 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 PFCC to have regard to the former Department for Communities and Local Government's Guidance on Minimum Revenue Provision (the MHCLG guidance) most recently issued in 2018.

7.2 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 grants, reasonably commensurate with the period implicit in the determination of those grants.

7.3 The MHCLG guidance requires the PFCC to approve an Annual MRP Statement each year (as part of the Capital Strategy) and recommends a number of options for calculating a prudent amount of MRP. The following guidance incorporates recommended options as well as locally determined prudent methods if applicable.

7.4 For capital expenditure incurred before 1st April 2008 MRP will be determined as 4% of the CFR in respect of that expenditure (Option 2 of the MHCLG guidance in

England and Wales).

7.5 For capital expenditure incurred after 31st March 2008, MRP will be determined by charging the expenditure over the expected useful life of the relevant asset (in equal instalments), starting in the year after the asset becomes operational e.g. capital expenditure incurred in 2024/25 will not be subject to an MRP charge until 2025/26.

7.6 The useful lives (as per paragraph 7.5) of the related assets for capital expenditure incurred after 31st March 2008 will be determined by reference to the PFCC's Property, Plant & Equipment accounting policy in the most recently published unaudited draft Statement of Accounts. This lists the different asset lives as follows:

- Buildings 20-60 years
- Vehicles 3-8 years
- Plant, IT & Equipment 3-30 years
- Marine Vessels 10-25 years

7.7 Whilst the above information sets out the ranges available, typically the standard estimated economic lives used by the PFCC in practice will be 40 years for buildings and seven years for shorter-life assets such as vehicles, plant & IT.

7.8 Purchase of freehold land will be charged over 50 years. MRP on expenditure not related to non-current assets but which has been capitalised by regulation or direction will be charged over 20 years (Option 3 of the MHCLG guidance in England and Wales).

7.9 If applicable, for any capital expenditure loans to third parties that are repaid in annual or more frequent instalments of principal, the PFCC will make nil MRP, but will instead apply the capital receipts arising from principal repayments to reduce the CFR instead. In years where there is no principal repayment, MRP will be charged in accordance with the MRP policy for the assets funded by the loan, including where appropriate, delaying MRP until the year after the assets become operational.

7.10 Based upon the PFCC's CFR forecast for 31st March 2024 included within the 2024/25 budget setting process, the budget for MRP for 2024/25 is as follows:

Table 8 – CFR and MRP Estimates

CAPITAL STRATEGY 2024/25 CFR AND MRP ESTIMATES	31/3/24 Budgeted CFR £000	2024/25 Budgeted MRP £000
Capital expenditure incurred before 1st April 2008	4,065	500
Capital expenditure incurred after 1st April 2008	21,507	784
Total	**25,572**	**1,284**

7.11 The CFR arising from the period prior to 1st April 2008 relates to miscellaneous unfinanced capital expenditure relating to various assets no longer held by the PFCC.

7.12 Whilst the guideline MRP for the pre-April 2008 expenditure is 4% (e.g. £164k per annum based on the forecast £4.1m of pre-2008 debt forecast to be held at the end of 2023/24) the PFCC has chosen to increase this to a more prudent £500k per annum. Whilst the current guidance allows for an outstanding CFR to be held in respect of assets no longer held it is the PFCC's intention to clear this debt as soon as possible (taking into account other budget constraints) and the £500k value being repaid per annum reflects this objective.

7.13 Where possible the PFCC will look to make additional MRP voluntary overpayments in respect of its post-April 2008 unfunded expenditure to limit the revenue impact on future financial years. However, it should be noted that these costs are not currently built into any element of the 2024/25 budget or within this strategy.0720

8.0 Knowledge and Skills

8.1. The PFCC and Chief Constable employs professionally qualified and experienced staff in senior positions, with responsibility for making capital expenditure, borrowing and investment decisions. These staff hold relevant CCAB professional qualifications and are members of recognised accounting bodies such as CIPFA and ACCA. These staff also have a number of years' experience working in public sector treasury management and capital accounting roles.

8.2 Where staff do not have the knowledge and skills required, use is made of external advisors and consultants that are specialists in their field. The PFCC currently employs Arlingclose Limited as treasury management advisors. This approach is more cost effective than employing such staff directly and ensures that the PFCC has access to knowledge and skills commensurate with its risk appetite.