

Devon and Cornwall Police Authority

16 February 2007

Open for the purposes of FOI

Report of the Treasurer

Treasury Management Strategy for 2007-08

Recommendations:

That the Treasury Management / Investment Strategy be approved, specifically in relation to :

- (i) retaining the services of Investec and Morley to invest surplus funds on behalf of the Police Authority, subject to satisfactory performance;**
- (ii) retaining the services of Devon County Council to provide day to day cash management on behalf of the Police Authority;**
- (iii) continuing to allow the Treasurer the flexibility to invest funds directly and to vary amounts with different managers, in consultation with the Chair of the Police Authority and Chair of Resources, if this is to the advantage of the Police Authority;**
- (iv) dealing in specified and non-specified investments, within the parameters defined in the strategy;**
- (v) undertaking long term borrowing in line with the approved capital programme and associated funding;**
- (vi) noting the use of Barclays as the Authority's bankers.**

Introduction

- 1.1 The Treasurer is required to present a Treasury Management Strategy to Members each year, setting out how investments, borrowing, cash flows and banking arrangements will operate during the year. In addition, Police Authorities are required to approve an Annual Investment Strategy before the start of the financial year. As in previous years, this draft document for 2007-08 incorporates both requirements and is now presented to members for their consideration and approval.
- 1.2 This document should be read in conjunction with the budget report elsewhere on this agenda, in particular the "Prudential Indicators" applicable to treasury management and borrowing requirements included in Section 12 of the Medium Term Financial Strategy pack.

2. Economic Context

- 2.1 The Bank of England has now raised interest rates three times this financial year but consumer spending, house prices and now inflation remain stubbornly high. It remains to be seen if further interest rate rises are inevitable now that inflation has reached 3%. Opinion is divided on when and at what rates the market will peak. Some forecasters are suggesting rates rising to 5.75%. Inflation is running above target and there may also be a real danger of too much correction producing a sudden fall in activity. The Chancellor will be looking for a soft landing.
- 2.2 For financial planning and budget setting purposes, it is assumed that interest rates will rise again with the likelihood of a fall in the second half of 2007. Borrowing will be timed accordingly.

Continued/.

3. Investment Strategy

3.1 The Authority has sufficient cash available to meet all expected short-term and operational requirements in the coming year. Prudent financial management has allowed the Authority to build up general balances, earmarked reserves and provisions. The illustrative budget expects balances and reserves to remain broadly static with a small reduction in provisions.

3.2 The illustrative budget presented to Members assumes a short-term deposit return of 5.4%. Under current circumstances this may err on the prudent side.

3.3 Short-term deposits continue to be divided between two external fund managers, Investec and Morley. It is proposed that the fund managers be allowed to continue to use a combination of specified and non-specified investments. Specified investments must continue to be in sterling, have a maturity value of no more than one year, and either be made with the UK government, a UK local authority or be with bodies or investments with high credit ratings. (A, AA or AAA are all generally accepted as "strong" to "extremely strong" in that order; "BBB" is adequate while anything less is increasingly speculative down to "C". From "AA" to "CCC", "+" and "-" show relative standing within the overall rating.) For some time now, the Authority has excluded US banks.

3.4 Day-to-day cashflow is managed on behalf of the Authority by Devon County Council (see section 5). From time to time funds not immediately needed may be released for longer investment.

3.5 Some AA and AAA institutions have an investment threshold above the Authority's expected level of short-term deposits. However, other institutions with lower thresholds (typically, high street building societies) generate a long term credit rating of A and a short term credit rating of F1. The risk associated with these investments is therefore low.

Continued/.

3.6 It is **recommended** that the current policy for credit rating continues: external fund managers to use AA- or above, and Devon County Council to use A or above for long term investments and F1 or above for short term investments.

3.7 It is **recommended** that the current policy for the use of non-specified investments by the external fund managers continues: limited to 30% of the overall portfolio and must be UK government bonds with maturity periods above one year and/or certificates of deposit with maturity periods between one year and two years and/or supranational bonds.

3.8 It is **recommended** that the average maximum duration for the portfolio held by each investment manager be 5 years, as amended by the Resources Committee in April 2006.

3.9 It is **recommended** that the fund managers continue to be allowed to trade in supranational bonds offering a yield premium over UK government bonds, subject to this being within the 30% limit for non-specified investments. The Treasurer will again advise the fund managers that any such trades are still to be discussed with him in advance of any transactions.

3.10 It is **recommended** that the maximum percentage of the portfolio which the fund managers can invest with any one institution continues at 15%.

3.11 The Treasurer will continue to monitor fund performance very closely and will discuss with the Resources Committee any necessary control action.

4. Capital Spending and Long Term Borrowing

4.1 The illustrative budget elsewhere on this agenda details borrowing to fund the proposed capital programme. If Members approve the illustrative budget, actual borrowing would be drawn down during the year with due regard to current interest rates and progress on spending. Loan periods will reflect the estimated useful life of the asset. The interest rate on long term borrowing

has been set at 4.60% for budget purposes. All borrowing is with the Public Works Loans Board, an executive agency of HM Treasury.

4.2 Current borrowing is for either 25.5 or 30.5 years (the first principal becomes repayable in 2029). Initial borrowing in 2004 was at 5.00% per annum while borrowing during 2005-06 and 2006-07 ranged between 4.40% and 4.95%. On a number of occasions, borrowing was secured just before rates rose.

4.3 The Authority has adopted the CIPFA *Prudential Code for Capital Finance in Local Authorities* and all borrowing is within the Code's Prudential Indicators detailed in Appendix A of the Budget report.

5. Cash Flow

5.1 Cash flow within the Medium Term Financial Strategy covers the three years to 2009-10.

5.2 Devon County Council manages daily cashflow for the Authority and works within the Investment Strategy detailed in Section 3 above. It uses only specified investments, Money Market funds and/or cash deposits where there is little potential for capital gains or losses.

5.3 It is **recommended** that, in consultation with the Chair of the Police Authority and the Chair of Resources, the Treasurer continues to be allowed to move funds between fund managers as necessary, and to invest Authority funds directly with a UK bank or building society as a specified investment, at a fixed rate of interest and with little risk of capital loss.

6. Monitoring

6.1 Performance and changes in borrowing, management and lending are all reported regularly to members of the Resources Committee. Representatives of the Committee meet with external managers periodically to assess progress. The last meeting was in December 2006.

7. Banking Arrangements

7.1 The Authority's bankers are Barclays PLC. The current contract for banking services expires on 31 March 2008.

8. Conclusion

8.1 This Treasury Management Strategy continues to develop based on:

- continuing to invest surplus cash with two external investment managers
- using specified and non specified investments within set parameters
- continuing to use Devon County Council for day to day cash management
- continuing to use Barclays as bankers
- regular monitoring of the strategy by the Treasurer and Resources Committee with comprehensive periodic reports.

8.2 The Treasurer will decide on appropriate long-term borrowing levels to meet the budget finally approved by Members in the light of prevailing and forecast interest rates.

John Glasby
Treasurer

Contact for information:
Adrian Rutter
Head of Technical Accounting
adrian.rutter@devonandcornwall.pnn.police.uk
01392 268319