

**Devon and Cornwall Police Authority**  
**15 February 2008**  
Open for the purposes of FOI  
Report of the Treasurer

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**Treasury Management Strategy for 2008-09**

**Recommendations:**

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| <p>That the Treasury Management / Investment Strategy be approved, and specifically:</p> <ul style="list-style-type: none"><li>(i) the Annual Investment Strategy is approved;</li><li>(ii) the Borrowing and Debt Management Strategy is approved;</li><li>(iii) that Investec are retained to invest surplus funds on behalf of the Police Authority, subject to satisfactory performance;</li><li>(iv) the services of Devon County Council are retained to provide day to day cash management on behalf of the Police Authority;</li><li>(v) that the Police Authority continues to operate a Devon and Cornwall Police Investment Fund managed by the Treasurer;</li><li>(vi) that the Treasurer should retain the flexibility to invest funds directly and to vary amounts invested with Investec and in the Devon and Cornwall Police Fund within the limits set out in the strategy;</li><li>(vii) the Treasurer be authorised to create and maintain a counterparty list consistent with the principles in this strategy and sensitive to publicised changes in the fortunes of individual institutions;</li><li>(viii) noting the use of Barclays as the Authority's bankers.</li></ul> |
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**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 2008-09 incorporates both requirements and is now presented to members for their consideration.
- 1.2 This document should be read in conjunction with the Three Year Financial Strategy report elsewhere on this agenda, in particular Annex 12 "Prudential Indicators" applicable to treasury management and borrowing requirements.

**2 Economic Context**

- 2.1 Over the last twelve months Bank of England base rates rose to 5.75% in June 2007 and then reduced to 5.5% in December 2007. However market rates have varied more widely from the base rate than is the norm due to a lack of liquidity in the markets from August to December 2007. Both economic fundamentals and the impact of changes in international financial markets are difficult to forecast for the coming year. Weakness in the US economy is expected to influence growth across the world but commodity prices are rising and this is likely to keep inflation levels high.

- 2.2 Forecasting interest rate movements is always difficult. Short term rates are linked to changes in the Bank of England's Base Rate. For financial planning and budget setting purposes it has been assumed that rates will fall over the coming year. The forecast for the average rate available on new lending is 4.25%, this is thought to be a cautious assessment. Long term rates are influenced by other factors e.g. the market in gilts. A rate of 4.9% has been assumed for new borrowing.

### **3 Use of External Fund Managers**

- 3.1 In September 2007 the Resources Committee reviewed the performance of the two fund managers who managed the Authority's investments. It was concluded that the performance of one of the managers was not satisfactory and the funds were withdrawn and placed in a new Devon and Cornwall Police Investment Fund.
- 3.2 In December 2007 a working group of members met with the remaining fund manager Investec to review their performance. This was judged to be satisfactory and this manager will be retained subject to on-going review of their performance.

### **4 Investment Strategy**

- 4.1 Subject to a balanced budget 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. Within the Three Year Financial Strategy balances and reserves to are progressively reduced. In 2008-9 the reduction is approximately £3m.
- 4.2 Investments are forecast to be approximately £39m as at 31 March 2008.
- 4.3 The Police Authority has four different mechanisms for investing surplus funds:
- Sterling investments managed by Investec the Authority's external fund managers ( forecast balance as at 31 March 2008 - £20 million);
  - euro investments managed by Investec (forecast balance as at 31 March 2008 2.0 million euros);
  - Devon and Cornwall Police Investment Fund managed by the Treasurer (forecast balance as at 31 March 2008 £17.5 million). This fund is invested solely in fixed interest deposits, the remit of the fund is contained at Annex 1;
  - very short term deposits varying from overnight to 3 months - managed by Devon County Council

#### Investment Strategy Principles

- 4.4 Guidance under section 15 (1) (a) of the Local Government Act requires the Authority to establish an Annual Investment Strategy. This part of the Treasury Management Strategy sets out how this guidance is complied with.

#### 4.5 Prudence

The Authority will at all times invest its surplus funds prudently. Priority will be given to security and liquidity rather than yield. However the highest available rate of interest consistent with proper levels of security and liquidity will always be sought.

#### 4.6 Specified Investments

Specified Investments are those offering high security and high liquidity and the Police Authority can freely rely on these with minimal procedural formalities. All such investments should be in sterling with a maturity of no more than one year. They include investments with the UK Government, UK Local Authorities and with banks, building societies or money market funds that have high credit ratings. Available funds may be invested in specified investments without reference to any specific limits.

#### 4.7 Non-Specified Investments

These are defined as any investments that do not meet the definition of specified investments. The Strategy must identify the types of Non-Specified Investments that may be used during the year, set maximum limits and lay down guidelines for making decisions.

4.8 Different limits and controls will be applied to the four different types of investment described a paragraph 4.3 above.

#### External Fund Manager

4.9 Investec will use counter parties rated AA- or above. Although this is the minimum investment will generally be with higher rated counterparties. The Credit rating agency used is Fitch IBCA.

4.10 All investments will be specified investments with the following exception:

Non-specified investments up to a limit of 30% of their overall portfolio may be used, these must be in UK government bonds with maturity period above one year and/or certificates of deposit with maturity periods between one year and two years and/or supranational bonds. The Treasurer will advise the manger that any trades in supranational bonds must be discussed with him in advance.

4.11 The maximum average duration for the portfolio held by the investment manager will be 5 years.

4.12 The maximum percentage of the portfolio which the fund manager can invest with any one institution is 15%

#### Euro Liquidity Fund

- 4.13 2 million euros are deposited with Investec in a Euro Liquidity Fund. This is a Non-Specified investment held for the specific purpose of funding the purchase of the helicopter that will be paid for in euros in 2009-10. A portion of the euros required to pay for the helicopter were purchased in advance as the value of the pound was forecast to fall against the euro.
- 4.14 This fund has an AAA credit rating from Standard and Poors.

#### Devon and Cornwall Police Investment Fund

- 4.15 The credit ratings applied to the Devon and Cornwall Police Investment Fund will be those provided by the Fitch IBCA credit ratings agency. Long term credit ratings of A or better combined with short term credit ratings of F are considered to be "high". Credit ratings are monitored monthly but downgrades or potential downgrades that are reported between reviews will be acted upon. Institutions with a high credit rating will be avoided if there is a valid reason to do so.
- 4.16 The counter party list is constructed according to the following principles:

<u>Counterparty Type</u>	<u>Credit Limit</u>
UK banks rated F1	£3 million
UK banks rated F1+	£5 million
Building Societies, Assets greater than £50 billion	£5 million
Building Societies, Assets less than £50 billion	£3 million
Foreign banks F1+	£5 million
Larger Local Authorities	£5 million
Smaller local authorities	£3 million
Debt Management Account (central government)	£10 million
Money Market Funds rated AAA	£5 million

Foreign banks rated F1 and below and US banks are excluded from the list.

- 4.17 Using the above principles produces a substantial list, however, the limits for individual institutions are relatively low and on some occasions difficulties have been encountered in finding counter parties with which the Police Authority has "headroom" who are willing to borrow. Given the current conditions in the banking sector it is not recommended to raise the limits for individual institutions. For these reasons the addition of building societies that do not have credit ratings, to the counter party list should be considered.
- 4.18 A number of mutual building societies have credit ratings and these institutions are included on the current counter party list according to the principles listed above. However some building societies do not have a rating. These are the building societies who have well over 50% (typically 60-90% of funding) of their funding from members deposits. As they are not reliant on the wholesale money market they do not need to obtain a rating. Some reassurance similar to that provided by a credit rating is however needed. This is provided by the existence

of the Building Societies Association that oversees the sector. Were a society to get into difficulties it would facilitate a merger with another society. It should be noted that nobody has lost money through the failure of a mutual building society since 1892. A further limit and control would be to include on the list only those building societies with assets of over £1 billion. It is therefore proposed that 12 mutual building societies are added to the counter party list with a limit of £3.0m. The list of the unrated building societies to be added to the list is attached as Annex 2. This new policy is consistent with the approach adopted by Devon County Council.

4.19 The full counterparty list should be approved by the Treasurer and will be in accordance with the principles outlined in paragraphs 4.15 and 4.16. Changes during the year will also be in accordance with the principles outlined above and should be approved by the Treasurer by the Treasurer .

4.20 All investments will be specified investments with the following exception:

Non-specified investments up to a limit of the lesser of £10m or 50% of the overall portfolio may be used, these must be fixed interest deposits with UK and Overseas banks, UK Building Societies, the Debt Management Deposit Facility, Local Authorities or pooled money market funds for more than 364 days

#### Daily Cash

4.20 This is managed on the Authority's behalf by Devon County Council. Performance has been excellent and continuation of this arrangement is recommended.

4.21 The counterparty list that is used for the Devon and Cornwall Police Investment Fund will be used for daily cash deposits. It will be operated in such a way that Investment Fund deposits and daily cash deposits when added together will not exceed the limit for any given counterparty.

4.22 All daily cash deposits will be specified investments.

#### Performance

4.23 The benchmark for performance for the external fund manager and the Investment fund will be the 7 day LIBID (London Interbank Rate)

### **5 Capital Spending and Long Term Borrowing**

5.1 The 3 Year Financial Strategy elsewhere on this agenda details borrowing to fund the proposed capital programme. If Members approve the Three Year Financial Strategy, 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 4.90% for budget purposes. All borrowing is with the Public Works Loans Board, an executive agency of HM Treasury.

- 5.2 Borrowing will be for between 25 and 30 years depending on the optimum rates available at the time borrowing takes place.
- 5.3 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 Annex 12 of the Three Year Financial Strategy report.

## **6 Cash Flow**

- 5.1 Cash flow within the 3 Year Financial Strategy covers the three years to 2010-11. A cashflow model has been used to forecast cash movements. The range of investments held by the Police Authority will be managed to ensure that sufficient funds are available to meet daily cash flow needs

## **7 Monitoring**

- 7.1 Income and expenditure will be monitored monthly to ascertain performance against the budget.
- 7.2 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 2007.

## **8 Banking Arrangements**

- 8.1 The Authority's bankers are Barclays PLC. The current contract for banking services expires on 31 March 2008. A contract re-negotiation exercise was entered into with Barclays PLC. This has yielded savings on the current contract and the contract will be extended for a further 3 years.

## **9 Conclusion**

- 9.1 The Treasury Management Strategy has developed during 2007-08 and a new Devon and Cornwall Police Investment Fund has been introduced. This fund has a different investment strategy to the Police Authority's external fund manager. This should lead to the risks inherent with adopting a single investment approach being mitigated by the use of a second investment approach. Close monitoring of the strategy will take place during the year to ensure that risks are properly managed and returns maximised. 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**

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**Devon and Cornwall Police Investment Fund**

**Purpose**

To invest cash balances to achieve best value in terms of return whilst giving primacy to the effective management and control of risk. This means that the security of the principal sums invested and the liquidity of funds will be given priority over yield.

**Investment Strategy**

- 1 Investments will be limited to fixed interest deposits with UK and Overseas banks and UK building societies, the Debt Management Account Deposit Facility provided by central government and pooled money market funds. Except in exceptional circumstances the focus will be on investments for 28 days or over.
- 2 Funds to be invested only with counter parties rated AA for long term investments and F1 or above for short term investments and in accordance with the approved counter-party list.
- 3 The fund will not invest directly in government bonds, certificates of deposit, foreign currency or international bonds.
- 4 Investments for more than one year are classified as non-specified investments. A limit of 50% of the overall portfolio will be placed on the amount of the fund that can be invested for period of more than 1 year.
- 5 The benchmark for performance will be the 7 day LIBID (London Inter Bank Bid Rate).
- 6 Investment decisions within the policy will be taken by the Treasurer after advice from officers of Devon County Council and Devon and Cornwall Police

**“Unrated” Building Societies to be added to the Counterparty List**

<b>Name of Society</b>	<b>Assets £m</b>
Leeds Building Society	8,142
Derbyshire Building Society	6,019
Cheshire Building Society	4,706
Norwich and Peterborough Building Society	3,671
Stroud and Swindon Building Society	2,804
Dunfermline Building Society	2,745
Nottingham Building Society	2,617
Scarborough Building Society	2,319
Kent Reliance Building Society	1,615
Progressive Building Society	1,333
Cumberland	1,285
National Counties Building Society	1,033