NORTHUMBRIA POLICE AND CRIME COMMISSIONER

Key Decision

Treasury Management Annual Report 2018/19

(PCC/ 398 /2019)

Summary

The Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (the Code) requires the Commissioner to receive a Treasury Management Annual Report on borrowing and investment activity by 30 September each year.

This report meets this requirement and informs the Commissioner of Treasury Management activity during 2018/19.

The report was reviewed by the Joint Independent Audit Committee at their meeting on 22 July 2019.

Recommendation

Approve the Treasury Management Annual Report as a true record of the activities for 2018/19, and publish it on the Commissioners website

Northumbria Police and Crime Commissioner

I hereby approve the recommendations above.

Signature **Date 02.09.19**

OPCC BUSINESS MEETING	02 SEPTEMBER 2019
TREASURY MANAGEMENT ANNUAL REPORT 2018/19	
REPORT OF: MIKE TAIT, CHIEF FINANCE OFFICER	
AUTHOR: KEVIN LAING, HEAD OF FINANCE	

1. PURPOSE

1.1 In-line with the Code of Practice on Treasury Management this report presents to the Police and Crime Commissioner (the Commissioner) the Treasury Management Annual Report for the financial year 2018/19, for review and acceptance.

2. RECOMMENDATIONS

2.1 The Police and Crime Commissioner is recommended to:

a) Review the attached Treasury Management Annual Report 2018/19; and

b) Approve the Treasury Management Annual Report as a true record of the activities for 2018/19, and publish it on the Commissioners website.

3. BACKGROUND

3.1 The Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (the Code) requires the Commissioner to receive a Treasury Management Annual Report on borrowing and investment activity by 30 September each year. This report meets this requirement and informs the Commissioner of Treasury Management activity during 2018/19.

3.2 In-line with good governance principles included within the Code, the attached Treasury Management Annual Report has been presented and reviewed by the Joint Independent Audit Committee on 22 July 2019.

4 KEY OUTCOMES

4.1 The Treasury Management Annual Report 2018/19 is attached at Appendix A. The key highlights are as follows:

- Borrowing costs were under budget due to borrowing being taken at lower interest rates than estimated, the use of internal cash resources and new long-term borrowing being deferred to later in the financial year on advice from external treasury advisers Link Asset Services.

- Investment income received was higher than budget, reflecting the increase in base rate in August 2018 increasing returns on investments and an increase in average investment balances due to underspends on revenue and capital budgets.

- We have complied with our financial regulations and all prudential indicators were within the limits set for the year.

5. CONSIDERATIONS

Freedom of Information	*Non-exempt*
Consultation	Yes
Resource	No
There are no additional financial considerations arising from this report.	
Equality	No
There are no equality implications arising from the content of this report.	
Legal	No
There are no legal considerations arising from the content of this report.	
Risk	No
There are no additional risk management implications directly arising from this report.	
Communication	Yes
To be reported to the PCC in line with The Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (the Code) by 30 September each year.	
Evaluation	No

Treasury Management Annual Report 2018/19

The Strategy for 2018/19

1. The 2018/19 Treasury Management Policy Statement and Strategy was approved by the Joint Independent Audit Committee on 25 February 2018 for presentation to the Police and Crime Commissioner (PCC). The key decision was approved by the PCC on 08 March 2018.

2. The formulation of the 2018/19 Treasury Management Strategy involved determining the appropriate borrowing and investment decisions with the prime objective of safeguarding assets and secondary objectives of managing liquidity, obtaining a reasonable rate of return on investments and minimising the costs of borrowing.

3. The Treasury Management Strategy fully complied with the requirements of The Chartered Institute of Public Finance and Accountancy Code of Practice on Treasury Management and covered the following:

    - Prospects for interest rates.
    - Treasury limits set for prudential indicators.
    - The borrowing strategy.
    - The investment strategy.

Investment Strategy

4. Investments are managed in-house using counterparties listed in an approved lending list consistent with the agreed Treasury Management Strategy. Investments are placed over a range of periods and are dependent on the assessed security of the counterparty, the liquidity requirements of the cash flow, actual interest rates and expectations of movements in interest rates.

5. The expectation for interest rates within the Treasury Management Strategy for 2018/19 anticipated the Bank Rate increasing three times to reach 1.25% by 2020. Tentative increases of 0.25% were forecast in quarter 3 of both 2018/19 and 2019/20. A further increase of 0.25% was forecast in quarter 2 of 2020/21 bringing the Bank Rate to 1.25% by September 2020. The Strategy noted that interest rate forecasting remained difficult with so many external influences weighing on the UK, particularly with the level of uncertainty over the final terms of Brexit.

6. The Treasury Management Strategy was to adopt caution in the management of the 2018/19 treasury operations. The interest rate market was monitored to allow the Chief Finance Officer (CFO) to adopt a pragmatic approach to any changing circumstances, having delegated powers to invest and manage the funds and monies of the Commissioner.

Borrowing Strategy

7. The borrowing strategy for 2018/19 was:

    - Consider the use of short term borrowing as a bridge until capital receipts are received.
    - Consider the use of market loans which are at least 20 basis points below the PWLB target rate, where they become available.

- Consider the use of PWLB loans where rates fall below Link Asset Services trigger rates, where required, with preference given to terms which ensure a balanced profile of debt maturity.

- Utilise reserve and General Fund balances to limit the requirement for new borrowing, reducing investment balances rather than increasing external borrowing in order to minimise interest costs.

- Maintain a flexible strategy in order to allow decisions on borrowing to be taken which balance the refinancing risk associated with an increase in interest rates against any potential short-term savings.

8. The early repayment of debt was not considered to present value for money during 2018/19, as the cost of premiums payable on the early repayment of debt continue to outweigh any potential savings on refinancing.

Treasury Management Compliance with Risk Strategy

9. The primary objective is to ensure the security of funds and minimise risks, including counterparty and interest rate risks. An Internal Audit review of the treasury management function in November 2018 gave the opinion that it was 'Operating Well'.

Outturn 2018/19 – Performance Measurement

10. Prudential indicators are set annually to ensure that borrowing is prudent, sustainable and affordable. Performance is monitored against these indicators throughout the year and reported in the quarterly capital monitoring reports to the Joint Business Meeting (JBM). The outturn against the prudential indicators confirms that all indicators were operating

External Advisers

11. Link Asset Services have continued to be used as external treasury management advisers to assist in achieving the objectives set out in the Treasury Policy Statement and Strategy and provide access to specialist skills and resources.

Market Interest Rates

12. Performance must be considered in conjunction with actual rate movements over the financial year which were as follows:

    - **Shorter-term interest rates**

      Investment returns remained low during 2018/19. The expectation for interest rates within the treasury management strategy for 2018/19 was that Bank Rate would rise from 0.50% to 0.75% in quarter 3. At the start of 2018-19, and after UK GDP growth had proved disappointingly weak in the first few months of 2018, the expectation for the timing of this increase was pushed back from May to August 2018. Investment interest rates were therefore on a gently rising trend in the first half of the year after April, in anticipation that the MPC would raise Bank Rate in August. This duly happened at the MPC meeting on 2 August 2018. It was not expected that the MPC would raise Bank Rate again during 2018/19 in view of the fact that the UK was entering into a time of major uncertainty with Brexit due in March 2019.

- **Longer-term interest rates**

  Interest rate forecasts expected only gradual rises in medium and longer term fixed borrowing rates during 2018/19 and the two subsequent financial years. Variable, or short-term rates, were expected to be the cheaper form of borrowing over the period. Since PWLB rates peaked during October 2018, most PWLB rates have been on a general downward trend, though longer term rates did spike upwards again during December, and, (apart from the 1 year rate), reached lows for the year at the end of March. There was a significant level of correlation between movements in US Treasury yields and UK gilt yields -which determine PWLB rates. The Fed in America increased the Fed Rate four times in 2018, making a total of nine increases during this cycle, to reach 2.25% – 2.50% in December. However, it had been giving forward guidance that rates could go up to nearly 3.50%. These rate increases and guidance caused Treasury yields to also move up. However financial markets considered by December 2018, that the Fed had gone too far, and discounted its expectations of further increases. Since then, the Fed has also come round to the view that there are probably going to be no more increases in this cycle. The issue now is how many cuts in the Fed Rate there will be and how soon, in order to support economic growth in the US. But weak growth now also looks to be the outlook for China and the EU so this will mean that world growth as a whole will be weak. Treasury yields have therefore fallen sharply during 2019 and gilt yields/PWLB rates have also fallen.

Investment Performance

13. The main focus for treasury management in 2018/19 has continued to be ensuring the security of investments whilst generating a reasonable rate of return. Due to the difference between the cost of borrowing and investment interest, cash balances have continued to be used to temporarily fund the capital programme. This has resulted in savings on the cost of borrowing and lower credit risk as the investment portfolio is reduced.

14. A continued use has been made of a range of investment instruments in order to maintain flexibility, spread risk, maximise liquidity and obtain attractive interest rates. The use of money market funds and notice reserve accounts, with high rated banks, has maintained the security of funds and enhanced the rate of return on investments.

15. A summary of the year's activity is shown at Appendix 2. The total interest earned in the year, was £0.114m (2017/18 £0.048m) with an average interest rate of 0.65% (2017/18 0.31%). The investment interest earned was an increase of £0.041m against the original budget of £0.073m. The increase in Bank Rate from 0.50% to 0.75% on 2 August 2018 helped boost investment returns in the last 7 months of the financial year.

16. The overall return on investments of 0.65% exceeds the accepted benchmark rate (the 7-day London Interbank Bid Rate (LIBID)) of 0.51%. The LIBID is used as a benchmark as it is linked to the base rate and provides a publically available national comparator. By actively managing our temporary investments, seeking the best rates and utilising spare capacity in certain accounts we have maximised the interest earned whilst operating within the constraints of the approved Treasury Management Policy.

Borrowing Performance

17. The total borrowing at 31 March 2019 was £102.969m, which was within the operational borrowing limit of £145.000m. This is a net decrease of £3.916m from the opening balance of £106.885m, represented by £84.000m new borrowing and repayments of £87.916m. The new borrowing was taken as set out in the following table:

Date	Term	Amount	Interest Rate	Sources
03/04/2018	94 days	£1.000m	0.85%	Market Loans
03/04/2018	94 days	£2.000m	0.85%	Market Loans
20/04/2018	18 days	£10.000m	0.45%	Market Loans
24/05/2018	14 days	£14.000m	0.50%	Market Loans
21/06/2018	14 days	£15.000m	0.48%	Market Loans
31/07/2018	7 days	£5.000m	0.43%	Market Loans
03/01/2019	32 days	£5.000m	0.75%	Market Loans
31/01/2019	154 days	£6.000m	0.95%	Market Loans
31/01/2019	154 days	£5.000m	0.95%	Market Loans
31/01/2019	154 days	£3.000m	0.95%	Market Loans
31/01/2019	154 days	£2.000m	0.95%	Market Loans
02/11/2018	9.5 years	£2.000m	2.18%	PWLB
02/11/2018	50.0 years	£2.000m	2.55%	PWLB
12/12/2018	9.5 years	£3.500m	1.98%	PWLB
12/12/2018	45.0 years	£3.500m	2.43%	PWLB
26/03/2019	10.0 years	£5.000m	1.86%	PWLB
	Total	£84.000m		

18. The use of reserve and General Fund balances to limit the requirement for new borrowing has continued to deliver savings in 2018/19, reducing investment balances rather than increasing external borrowing in order to minimise interest costs.

19. The average borrowing interest rate at 31 March 2019 was 3.25% compared to 3.29% at 31March 2018. This slight reduction reflects the repayment of PWLB loans at higher interest rates and new PWLB borrowing secured at lower rates that was only partly offset by increases in short term borrowing rates.

20. The use of temporary short term borrowing is delivering savings in the short term but carries potential interest rate risk, if rates rise and there is a requirement to re-finance.

21. At 31 March 2019, £86.969m of the total borrowing was from the PWLB with the remaining £16.000m taken from market loans.

22. The overall revenue cost of borrowing in 2018/19 was £2.783m. This was £0.237m less than the budget. Forecast new PWLB borrowing was secured at rates lower than budget, and despite the increase in the Bank Rate in August 2018 average short term rates have remained within the budget set at 0.80% to December 2018 and 1.05% onwards

Debt Restructuring and Repayment

23. Due to the differential between current and historic interest rates it was anticipated that there would be little scope to restructure PWLB debt. This situation was monitored throughout the year and the cost of early repayment continues to outweigh any savings, therefore there was no early redemption or restructuring of debt.

Summary of Treasury Management performance for the year 2018/19

24. Investment income was £0.041m over budget reflecting the increased rates, particularly after the Bank Rate increase in August 2018, increasing the return on investments.

25. Borrowing costs were £0.237m less than the budget. Despite the increase in the Bank of England base rate in August 2018, average short term temporary borrowing rates have remained within the budget set. The Commissioner has continued to take advantage of low cost temporary borrowing rates and to maximise the use of internal borrowing available through reserve balances and capital receipts.

26. Overall Treasury Management performance against budget for 2018/19 generated a saving of £0.278m as summarised in the following table:

	2018/19 Budget £m	2018/19 Actual £m	2018/19 Saving £m
Cost of Borrowing	3.020	2.783	(0.237)
Investment Income	(0.073)	(0.114)	(0.041)
Net Position	**2.947**	**2.669**	**(0.278)**

Prudential Indicators 2018/19

Authorised Limit for External Debt		
	2018/19 Reported Indicator £m	2018/19 Maximum YTD £m
Borrowing	170.000	124.885
Other Long Term Liabilities	0.000	0.000
Total	**170.000**	**124.885**

Operational Boundary for External Debt		
	2018/19 Reported Indicator £m	2018/19 Maximum YTD £m
Borrowing	145.000	124.885
Other Long Term Liabilities	0.000	0.000
Total	**145.000**	**124.885**

Upper Limit on amounts invested beyond 364 days			
	2018/19 Reported Indicator £m	2018/19 Outturn £m	2018/19 Maximum YTD £m
Investments	**15.000**	**0**	**0**

Investment Activity

Investments maturing during the year		
	2017/18	**2018/19**
Number of investments made in the previous year, maturing in the reporting year	0	0
Number of investments made in the reporting year, maturing in the reporting year	643	762
Total number of investments maturing in the reporting year	643	762
Number of investments made in reporting year, maturing in the following year	0	**0**

Average duration of investments		
	2017/18	**2018/19**
Average duration of investments (including overnight)	1 day	1 day
Average duration of investments (excluding overnight)	51 days	33 days

Summary of non-specified investments		
	2017/18	**2018/19**
Non-specified investments:		
Rated non-high		
Approved limit	75%	75%
Maximum level invested	44%	37%
Not Rated		
Approved limit	0%	0%
Maximum level invested*	29%	1%
Investments over 364 days		
Approved limit	20%	20%
Maximum level invested	0%	0%

*The *Not Rated* investment relates to the impaired balance with Heritable Bank. The balance has not changed over the 2 year period shown, however its value relative to total investments can vary on any particular day. The 29% level in 2017/18 represented the position on 4 July 2017 when overall investment balances were only £0.152m, prior to receipt of the Home Office pension top-up grant the following day. In 2018/19 the minimum level of investment balances was higher so the relative value to total investment was much lower.

Gross Debt and Capital Financing Requirement (CFR)

Gross Debt and CFR	**2018/19 Estimate £m**	**2018/19 Outturn £m**
Borrowing as at 31 March	94.446	102.969
Capital Financing Requirement as at 31 March	103.189	106.959
Amount of Borrowing (over) / under CFR	**8.743**	**3.990**

Actual borrowing as at 31 March 2019 is below CFR by £3.990m. The actual borrowing position is closer to the CFR than estimated at the start of the year, by £4.753m. This can be attributed to additional PWLB borrowing secured in March 2019 when interest rates reached lows for the year.

In light of the forecast rising CFR over the Medium Term Financial Strategy (MTFS) period, this new borrowing was brought forward to 2018/19 to take advantage of the low interest rate on advice from external advisers Link Asset Services.