NORTHUMBRIA POLICE AND CRIME COMMISSIONER

Key Decision

Treasury Management Annual Report 2019/20

(PCC/ /2020)

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 2019/20.

The report was reviewed by the Joint Independent Audit Committee at their meeting on 22 June 2020.

Recommendation

Approve the Treasury Management Annual Report as a true record of the activities for 2019/20, and publish it on the Commissioners website

Northumbria Police and Crime Commissioner

I hereby approve the recommendations above.

Signature **Date 16.07.2020**

OPCC BUSINESS MEETING	16 JULY 2020
TREASURY MANAGEMENT ANNUAL REPORT 2019/20	
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 2019/20, for review and acceptance.

2. RECOMMENDATIONS

2.1 The Police and Crime Commissioner is recommended to:

a) Review the attached Treasury Management Annual Report 2019/20; and

b) Approve the Treasury Management Annual Report as a true record of the activities for 2019/20, 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 the requirement and informs the Commissioner of Treasury Management activity during 2019/20.

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 June 2020.

4 KEY OUTCOMES

4.1 The Treasury Management Annual Report 2019/20 is attached at Appendix A. The key highlights are as follows:

- Borrowing costs were under budget due to new long-term borrowing being taken at lower interest rates than estimated and deferred to later in the financial year. In addition, the base rate increases expected in 2019/20, at the time of setting the budget, did not take place; in reality interest rates were reduced further as part of emergency measures implemented by the Monetary Policy Committee (MPC) on 09 March and 19 March 2020 in an attempt to help offset the economic impact from the Coronavirus pandemic. These resulted in the cost of temporary borrowing being lower than estimated.

- Investment income received was higher than budget due to an increase in average balances available to invest, attributed to a number of reserve balances being higher than expected at budget setting time, grant funding received earlier in the year than anticipated and the profile of capital spending.

- All Financial Regulations have been complied with and all Prudential Indicators were within the limits set for the year within the Treasury Management Strategy

5. CONSIDERATIONS

<table>
<tr><td>Freedom of Information</td><td>Non-exempt</td></tr>
<tr><td>Consultation</td><td>Yes</td></tr>
<tr><td>Resource</td><td>No</td></tr>
<tr><td colspan="2">There are no additional financial considerations arising from this report.</td></tr>
<tr><td>Equality</td><td>No</td></tr>
<tr><td colspan="2">There are no equality implications arising from the content of this report.</td></tr>
<tr><td>Legal</td><td>No</td></tr>
<tr><td colspan="2">There are no legal considerations arising from the content of this report.</td></tr>
<tr><td>Risk</td><td>No</td></tr>
<tr><td colspan="2">There are no additional risk management implications directly arising from this report.</td></tr>
<tr><td>Communication</td><td>Yes</td></tr>
<tr><td colspan="2">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.</td></tr>
<tr><td>Evaluation</td><td>No</td></tr>
</table>

6 Treasury Management Annual Report 2019/20

The Strategy for 2019/20

1. The 2019/20 Treasury Management Policy Statement and Strategy was approved by the Joint Independent Audit Committee (JIAC) on 25 February 2019 for presentation to the Police and Crime Commissioner (PCC). The key decision was approved by the PCC on 28 February 2019.

2. The formulation of the 2019/20 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 2019/20 anticipated the Bank Rate increasing twice to reach 1.25% by March 2020. Tentative increases of 0.25% were forecast in May 2019 and February 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 2019/20 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 2019/20 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.

- Consider the use of 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 2019/20, 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 October 2019 gave the opinion that it was 'Operating Well'.

Outturn 2019/20 – Performance Measurement

8. 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 within agreed limits with no breaches throughout the year. For completeness a copy of the prudential indicators is attached at Appendix 1.

External Advisers

10. 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.

Interest Rates

11. 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 2019/20. The expectation for interest rates within the Treasury Management Strategy for 2019/20 anticipated the Bank Rate increasing twice to reach 1.25% by March 2020. Tentative increases of 0.25% were forecast in May 2019 and February 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.

  The Bank Rate remained at 0.75% during 2019/20 until two emergency cuts by the Monetary Policy Committee (MPC) on 09 March and 19 March 2020, an attempt to help offset the economic impact from the Coronavirus pandemic. The Bank Rate at 31 March 2020 was 0.1%, a historic low.

Shorter-term investment interest rates were therefore fairly flat during most of the year, until the two cuts in bank rate in March 2020 which caused investment rates to fall sharply.

- **Longer-term interest rates**

  Interest rate forecasts expected only gradual rises in medium and longer-term fixed borrowing rates during 2019/20, and the two subsequent financial years. Variable, or short-term rates, were expected to be the cheaper form of borrowing over the period.

  The PCC relies mainly on the Public Works Loans Board (PWLB) for medium to long-term borrowing. PWLB rates are based on gilt yields (UK Government bonds) and set by HM Treasury determining a specified margin to add to gilt yields. There was much speculation during the second half of 2019 that bond markets were in a bubble which was driving bond prices up and yields down to historically very low levels. The context for this included a number of conditions which were conducive to very low bond yields:

  - Heightened expectations that the US could have been heading for a recession in 2020.
  - A general background of a downturn in world economic growth, especially due to fears around the impact of the trade war between the US and China.
  - Inflation generally at low levels in most countries, and expected to remain subdued.

  Gilt yields were on a generally falling trend during the year up until the Coronavirus pandemic hit western economies. Since then, gilt yields have fallen sharply to unprecedented lows as investors have panicked in selling shares in anticipation of impending recessions in western economies, and moved cash into safe haven assets i.e. government bonds.

  However, during 2019/20 HM Treasury imposed a change in the margins applied over gilt yields for PWLB rates effectively adding a further 1% to all PWLB rates going forward. This unexpected increase in the cost of long-term borrowing is further explained below.

Increase in the cost of borrowing from the PWLB

12. On 09 October 2019, Her Majesty's Treasury (HMT) and the PWLB announced an increase in the margin over gilt yields of 100bps on top of the current margin of 80 bps which the PCC has paid prior to this date for new borrowing from the PWLB. This effectively adds a further 1% to all PWLB interest rates going forward. There was no prior warning that this would happen.

13. Whilst the government states that it supports the investment of capital by Local Authorities (and PCC's) in their communities in part by offering low cost loans through the PWLB, in recent years a minority of councils have used this cheap finance to buy significant amounts of commercial property for rental income, which reduces the availability of PWLB finance for core local authority activities.

14. To address this, HM Treasury have already clearly taken steps to increase the cost of PWLB finance, and are currently consulting on further changes to cut interest rates for investment in social housing and making available discounted loans for local infrastructure projects.

15. Whereas the PCC has previously relied on the PWLB as its main source of long term funding, consideration will need to be made taking account of other sources of borrowing going forward. At the current time this is a developmental area, as this was an unexpected event for the financial services industry. It is expected that various financial institutions will

enter the market or make products available to PCC's and Local Authorities as an alternative to PWLB borrowing. The PCC will be updated by treasury advisers Link Asset Services as this area evolves.

16. This increase in PWLB rates did not impact on the PCC's cost of borrowing in 2019/20 as all planned PWLB borrowing for the financial year was completed prior to this change. Looking forward over the medium term the two PWLB maturities which will be replaced with new borrowing are not anticipated to have an increase on borrowing costs overall. The expectation is that these can still be replaced with similar medium to long-term borrowing at lower rates.

17. Advice from Link Asset Services is that there is likely to be little upward movement in PWLB rates over the next two years as it will take national economies a prolonged period to recover all the momentum they will lose in the sharp recession that will be caused during the Coronavirus shut down period. Inflation is also likely to be very low during this period and could even turn negative in some major western economies during 2020/21.

Investment Performance

18. The main focus for treasury management in 2019/20 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 continued savings on the cost of borrowing and lower credit risk as the investment portfolio is reduced.

19. 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.

20. A summary of the year's activity is shown at Appendix 2. The total interest earned in the year was £0.284m (2018/19 £0.114m) with an average interest rate of 0.85% (2018/19 0.65%). The investment interest earned was an increase of £0.129m against the original budget of £0.155m. The Bank Rate remained at 0.75% during 2019/20 until two emergency cuts on 09 March and 19 March 2020; in an attempt to help offset the economic impact from the Coronavirus pandemic. The Base rate at 31 March 2020 was 0.1%, a historic low.

21. The overall return on investments of 0.85% exceeds the accepted benchmark rate (the 7-day London Interbank Bid Rate (LIBID)) of 0.54%. 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. During 2019/20 the additional investment income earned over the budget is attributed to average investment balances being significantly higher than budgeted which has also provided the opportunity to place funds for longer periods, achieving higher interest rates than the overnight rates in Money Market Funds. The increase in funds available is attributed to a number of reserve balances being higher than expected at budget setting time, grant funding received earlier in the year than anticipated and under spends on the capital programme, both within the 2018/19 outturn and during the 2019/20 financial year

Borrowing Performance

22. The total borrowing at 31 March 2020 was £90.969m, which was within the operational borrowing limit of £150.000m. This is a net decrease of £12.000m from the opening balance of £102.969m, represented by £56.000m new borrowing and repayments of £68.000m. The new borrowing was taken as set out in the following table:

Date	Term	Amount	Interest Rate	Sources
01/05/2019	64 days	£1.000m	0.85%	Market Loans
01/05/2019	64 days	£3.000m	0.85%	Market Loans
21/05/2019	44 days	£7.000m	0.45%	Market Loans
04/07/2019	1 days	£20.000m	0.50%	Market Loans
04/07/2019	1 days	£6.000m	0.48%	Market Loans
02/12/2019	7 days	£2.000m	0.43%	Market Loans
11/12/2019	92 days	£4.000m	0.75%	Market Loans
20/12/2019	200 days	£2.000m	0.95%	Market Loans
12/12/2019	208 days	£2.000m	0.95%	Market Loans
03/02/2020	4 days	£4.000m	0.95%	Market Loans
01/10/2019	8 years	£5.000m	1.17%	PWLB
	Total	£56.000m		

23. The use of reserve and General Fund balances to limit the requirement for new borrowing has continued to deliver savings in 2019/20, reducing investment balances rather than increasing external borrowing in order to minimise interest costs.

24. The average borrowing interest rate at 31 March 2020 was 3.08% compared to 3.09% at 31 March 2019. This slight reduction reflects the repayment of PWLB loans at higher interest rates and new PWLB borrowing secured at lower rates.

25. At 31 March 2020, £81.969m of the total borrowing was from the PWLB with the remaining £9.000m taken from market loans.

26. The overall revenue cost of borrowing in 2019/20 was £2.871m. This was £0.399m less than the budget. This reflects the reduced requirement following the 2018/19 capital outturn underspend and the revised profile of capital expenditure over the medium term. It also relates to PWLB borrowing taken later in the year than budgeted and secured at a significantly lower than the budgeted rate. The base rate increase expected in 2019/20 at the time of setting the budget did not take place and indeed the base rate has had two emergency cuts on the 9 and 19 March 2020 in an attempt to help offset the economic fallout from the Coronavirus pandemic.

Debt Restructuring and Repayment

27. 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 2019/20

28. Investment income was £0.129m over the budget set for the year. Average investment balances have been significantly higher than budgeted which has provided the opportunity to place funds for longer periods, achieving higher interest rates than the overnight rates in Money Market Funds. The increase in funds available is attributed to a number of reserve balances being higher than expected at budget setting time, grant funding received earlier in the year than anticipated and under spends on the capital programme, both within the 2018/19 outturn and during the 2019/20 financial year.

29. Borrowing costs were £0.399m less than budget reflecting the reduced borrowing requirement following an underspend on capital expenditure for 2018/19 and the revised profile of capital expenditure for 2019/20. Long-term PWLB borrowing for 2019/20 was taken later in the year than planned and secured at 1.17%, which is significantly lower than the budgeted rate of 2.90%. The base rate increase expected in 2019/20 at the time of setting the budget did not take place and indeed the base rate has had two emergency cuts on 9 March and 19 March 2020, an attempt to help offset the economic impact expected from the Coronavirus pandemic. As a result, short-term temporary borrowing has remained low throughout the 2019/20 financial year.

30. 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.

31. Overall Treasury Management performance against budget for 2019/20 generated a saving of £0.528m as summarised in the following table:

	2019/20 Budget £m	2019/20 Actual £m	2019/20 Saving £m
Cost of Borrowing	3.270	2.871	(0.399)
Investment Income	(0.155)	(0.284)	(0.129)
Net Position	**3.115**	**2.587**	**(0.528)**

Prudential Indicators 2019/20

Authorised Limit for External Debt		
	2019/20 Reported Indicator £m	2019/20 Maximum YTD £m
Borrowing	175.000	108.969
Other Long Term Liabilities	0.000	0.000
Total	**175.000**	**108.969**

Operational Boundary for External Debt		
	2019/20 Reported Indicator £m	2019/20 Maximum YTD £m
Borrowing	150.000	108.969
Other Long Term Liabilities	0.000	0.000
Total	**150.000**	**108.969**

Upper Limit on amounts invested beyond 364 days			
	2019/20 Reported Indicator £m	2019/20 Outturn £m	2019/20 Maximum YTD £m
Investments	**15.000**	**0**	**0**

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9 Investment Activity

Investments maturing during the year		
	2018/19	**2019/20**
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	762	658
Total number of investments maturing in the reporting year	762	657
Number of investments made in reporting year, maturing in the following year	0	1

Average duration of investments		
	2018/19	**2019/20**
Average duration of investments (including overnight)	1 day	2 days
Average duration of investments (excluding overnight)	33 days	162 days

Summary of non-specified investments		
	2018/19	**2019/20**
Non-specified investments: Rated non-high Approved limit Maximum level invested	 75% 37%	 75% 29%
Not Rated Approved limit Maximum level invested*	 0% 1%	 0% 1.9%
Investments over 364 days Approved limit Maximum level invested	 20% 0%	 20% 0%

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11 *The *Not Rated* investment relates to a small impaired balance remaining with Heritable Bank. The balance has not changed over the 2 year period shown, however its value relative to total investments can vary on a particular day.

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Gross Debt and Capital Financing Requirement (CFR)

Gross Debt and CFR	2019/20 Estimate £m	2019/20 Outturn £m
Borrowing as at 31 March	93.713	90.969
Capital Financing Requirement as at 31 March	108.744	110.043
Amount of Borrowing (over) / under CFR	**15.031**	**19,074**

The actual £19.074m under borrowing reflects an increase in reserve balances and the positive impact on the working capital position as at the year-end.