NORTHUMBRIA POLICE AND CRIME COMMISSIONER

Key Decision

Treasury Management Annual Report 2020/21

(PCC/450/2021)

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 2020/21.

The report was reviewed by the Joint Independent Audit Committee at their meeting on 19 July 2021.

Recommendation

Approve the Treasury Management Annual Report as a true record of the activities for 2020/21, and publish it on the Commissioners website

Northumbria Police and Crime Commissioner

I hereby approve the recommendations above

Signature **Date 05/08/2021**

OPCC BUSINESS MEETING	05 AUGUST 2021
TREASURY MANAGEMENT ANNUAL REPORT 2020/21	
REPORT OF: THE JOINT 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 2020/21, for review and acceptance.

2. RECOMMENDATION

2.1 The Commissioner is recommended to:

a) Review the attached Treasury Management Annual Report 2020/21; and

b) Approve the Treasury Management Annual Report as a true record of the activities for 2020/21, 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 2020/21.

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 19 July 2021.

4 KEY OUTCOMES

4.1 The Treasury Management Annual Report 2020/21 is attached at Appendix A. The key highlights are as follows:

- Both borrowing costs and investment income were reduced due to the two emergency cuts in base rate on 09 March and 19 March 2020 in an attempt to help offset the economic impact expected from the Coronavirus pandemic. These had not been anticipated in the original budget and Strategy.
- The net position from borrowing and investment activity for the year was a net positive position of £287k above the budgeted amount.
- 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

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 2020/21

The Strategy for 2020/21

1. The 2020/21 Treasury Management Policy Statement and Strategy was approved by the Joint Independent Audit Committee (JIAC) on 24 February 2020 for presentation to the Police and Crime Commissioner (PCC). The key decision was approved by the PCC on 11 March 2020.

2. The formulation of the 2020/21 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 2020/21 anticipated Bank Rate to remain unchanged at 0.75% up to March 2021. 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 2020/21 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 2020/21 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 Group 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 2020/21, 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 January 2021 gave the opinion that it was 'Operating Well'.

Outturn 2020/21 – 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 Group 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.

Investment strategy and control of interest rate risk

11. Investment returns which had been low during 2019/20, plunged during 2020/21 to near zero or even into negative territory. Nationally, most PCC and local authority lending managed to avoid negative rates and one feature of the year was the growth of inter local authority lending. The expectation for interest rates within the treasury management strategy for 2020/21 was that Bank Rate would remain at 0.75% for the entire year. This forecast was invalidated by the Covid-19 pandemic bursting onto the scene in March 2020 which caused the Monetary Policy Committee to cut Bank Rate in March, first to 0.25% and then to 0.10%, in order to counter the hugely negative impact of the national lockdown on large swathes of the economy. The Bank of England and the Government also introduced new programmes of supplying the banking system and the economy with massive amounts of cheap credit so that banks could help cash-starved businesses to survive the lockdown. The Government also supplied huge amounts of finance to local authorities to pass on to businesses. This meant that for most of the year there was much more liquidity in financial markets than there was demand to borrow, with the consequent effect that investment earnings rates plummeted.

12. Investment balances have been kept to a minimum through the agreed strategy of using reserves and balances to support internal borrowing, rather than borrowing externally from the financial markets. External borrowing would have incurred an additional cost, due to the differential between borrowing and investment rates in addition to the arrangement fees paid to brokers. Such an approach has also provided benefits in terms of reducing the counterparty risk exposure, by having fewer investments placed in the financial markets.

Borrowing strategy and control of interest rate risk

13. During 2020/21, the PCC maintained an under-borrowed position. This meant that the capital borrowing need, the Capital Financing Requirement (CFR) was not fully funded with loan debt, as cash supporting the PCC's reserves, balances and cash flow was used as an interim measure. This strategy was prudent as investment returns were very low and at times near to zero.

14. The policy of avoiding new borrowing by running down spare cash balances, has served well over the last few years. However, this was kept under review to avoid incurring higher borrowing costs in the future when this authority may not be able to avoid new borrowing to finance capital expenditure and/or the refinancing of maturing debt.

15. Against this background and the risks within the economic forecast, caution was adopted with the treasury operations. The Director of Finance has monitored interest rates in financial markets and adopted a pragmatic strategy based upon the following principles to manage interest rate risks:

    - if it had been felt that there was a significant risk of a sharp FALL in long and short term rates, (e.g. due to a marked increase of risks around relapse into recession or of risks of deflation), then long term borrowings would have been postponed, and potential rescheduling from fixed rate funding into short term borrowing would have been considered.

    - if it had been felt that there was a significant risk of a much sharper RISE in long and short term rates than initially expected, perhaps arising from an acceleration in the start date and in the rate of increase in central rates in the USA and UK, an increase in world economic activity or a sudden increase in inflation risks, then the portfolio position would have been re-appraised. Most likely, fixed rate funding would have been drawn whilst interest rates were lower than they were projected to be in the next few years.

16. Interest rate forecasts expected only gradual rises in medium and longer term fixed borrowing rates during 2020/21 and the two subsequent financial years. Variable, or short-term rates, were expected to be the cheaper form of borrowing over the period.

Investment Performance

17. The main focus for treasury management in 2020/21 has continued to be ensuring the security of investments whilst generating a positive rate of return in an environment of extremely low rates. 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.

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

19. A summary of the year's activity is shown at Appendix 2. The total interest earned in the year was £0.143m (2019/20 £0.284m) with an average interest rate of 0.37% (2019/20 0.85%). The investment interest earned was a reduction of £0.112m against the original budget of £0.255m. The Bank Rate remained at 0.01%, a historic low, during 2020/21 following the two emergency cuts on 09 March and 19 March 2020 in an attempt to help offset the economic impact from the Coronavirus pandemic.

20. The overall return on investments of 0.37% exceeds the accepted benchmark rate (the 7-day London Interbank Bid Rate (LIBID)) of (-) 0.07%. The LIBID is used as a benchmark as it is

linked to the base rate and provides a publically available national comparator. Due to the pressure in interest rates this has been negative during 2020/21. 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 2020/21 the investment income earned was below budget due to the reduction in interest rates following the two emergency cuts in bank rate in March 2020, which were not forecasted at budget setting time.

Borrowing Performance

21. The total borrowing at 31 March 2021 was £93.469m, which was within the operational borrowing limit of £155.000m. This is a net increase of £2.500m from the opening balance of £90.969m, represented by £17.500m new borrowing and repayments of £15.000m. All new borrowing was short term with no new long term PWLB borrowing taken or required in 2020/21. The new borrowing was taken as set out in the following table:

Date	Term	Amount	Interest Rate	Sources
04/05/2020	64 days	£1.000m	0.50%	Market Loans
22/05/2020	46 days	£10.000m	0.58%	Market Loans
24/03/2021	44 days	£6.500m	0.10%	Market Loans
	Total	£17.500m		

22. The use of reserve and General Fund balances to limit the requirement for new borrowing has continued to deliver savings in 2020/21, reducing investment balances rather than increasing external borrowing in order to minimise interest costs.

23. The average borrowing interest rate at 31 March 2021was 3.15% compared to 3.08% at 31 March 2020. This slight increase was due to the impact of fewer short term loan requirements during 2020/21 which means the average rate is more affected by the higher long term fixed rate PWLB loans already in place.

24. At 31 March 2021, £81.969m of the total borrowing was from the PWLB with the remaining £11.500m taken from market loans.

25. The overall revenue cost of borrowing in 2020/21 was £2.828m. This was £0.342m less than the budget. This reflects the reduced requirement following the 2020/21 capital outturn underspend and the revised profile of capital expenditure over the medium term. The increase in reserves and with base rate emergency cuts on the 9 and 19 March 2020 also meant short term interest rates were lower than budgeted for.

Heritable Bank

26. When Heritable Bank entered administration in October 2008 the former Police Authority had £5.238m invested which was due to mature with interest by the end of 2008/09; the total value including accrued interest was £5.300m. In 2010/11 the investment was impaired to reflect an expected return of 90p in the £.

27. At the end of the 2019/20 financial year, a total of fifteen dividends had been received in respect of this investment.

28. On 29 July 2020 the administrators confirmed the sixteenth and final dividend, a further 0.95p in the £ equating to £0.050m for Northumbria Police. Total dividends received in relation to the investment in Heritable Bank are £5.244m, equivalent to 98.95p in the £.

29. As the original investment was impaired in 2010/11 to reflect the expected return, all additional income above 90p in the £ is revenue income and is reflected as additional investment income in the accounts of the Police and Crime Commissioner 2020/21.

30. The mid-year report stated that no further dividends would be paid and the matter was now concluded. However, a small payment of £0.007m was received in December 2020 which was explained as a composition payment relating to a contingent claim against LBI ehf, the parent company of Heritable Bank. The composition payment was contingent on the final total return to Heritable's non-preferential unsecured creditors. This has been added to the other investment income figure in the Commissioners capital financing budget.

Debt Restructuring and Repayment

31. 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 2020/21

32. Investment Interest was £0.112m under the budget set for the year. Average investment balances have been higher than budgeted providing the opportunity to place funds for longer periods. However any benefit has been negated by the fall in interest rates resulting from the emergency cuts to Bank Rate in March 2020. The reduced investment interest of £0.112m was partly offset by other investment income totalling £0.057m in relation to the investment held by the former Police Authority with Heritable Bank.

33. Borrowing costs were £0.342m less than budget reflecting the reduced borrowing requirement following an underspend on capital expenditure for both 2019/20 and 2020/21. At the time of setting the budget, the base rate had been expected to remain at 0.75% during in 2020/21. This was not the case, and indeed the base rate has had two emergency cuts on 9 March and 19 March 2020 in an attempt to help offset the economic impact expected from the Coronavirus pandemic. As a result, short-term temporary borrowing costs remained low throughout the 2020/21 financial year.

34. 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.

35. Overall Treasury Management performance against budget for 2020/21 generated a saving of £0.287m as summarised in the following table:

	2020/21 Budget £m	2020/21 Actual £m	2020/21 Saving £m
Borrowing Interest	3.170	2.828	(0.342)
Investment Interest	(0.255)	(0.143)	0.112
Other Investment Income	-	(0.057)	(0.057)
Net Position	**2.915**	**2.628**	**(0.287)**

Prudential Indicators 2020/21

Authorised Limit* for External Debt		
	2020/21 Reported Indicator £m	**2020/21 Maximum YTD £m**
Borrowing	175.000	101.969
Other Long Term Liabilities	0.000	0.000
Total	**175.000**	**101.969**

Operational Boundary** for External Debt		
	2020/21 Reported Indicator £m	**2020/21 Maximum YTD £m**
Borrowing	155.000	101.969
Other Long Term Liabilities	0.000	0.000
Total	**150.000**	**101.969**

Upper Limit on amounts invested beyond 364 days			
	2020/21 Reported Indicator £m	**2020/21 Outturn £m**	**2020/21 Maximum YTD £m**
Investments	**15.000**	**0**	**0**

***The authorised limit -** the authorised limit is the "affordable borrowing limit" required by s3 of the Local Government Act 2003. Once this has been set, the Council does not have the power to borrow above this level. The table below demonstrates that during 2020/21 the Council has maintained gross borrowing within its authorised limit.

****The operational boundary** – the operational boundary is the expected borrowing position of the Council during the year. Periods where the actual position is either below or over the boundary are acceptable subject to the authorised limit not being breached.

Investment Activity

Investments maturing during the year		
	2019/20	**2020/21**
Number of investments made in the previous year, maturing in the reporting year	0	1
Number of investments made in the reporting year, maturing in the reporting year	658	702
Total number of investments maturing in the reporting year	657	701
Number of investments made in reporting year, maturing in the following year	1	2

Average duration of investments		
	2019/20	**2020/21**
Average duration of investments (including overnight)	2 day	2 days
Average duration of investments (excluding overnight)	162 days	68 days

Summary of non-specified investments		
	2019/20	**2020/21**
Non-specified investments:		
Rated non-high		
Approved limit	75%	75%
Maximum level invested	29%	18%
Not Rated		
Approved limit	0%	0%
Maximum level invested*	1.9%	3.1%
Investments over 364 days		
Approved limit	20%	20%
Maximum level invested	0%	0%

*The *Not Rated* investment relates to a small impaired balance remaining with Heritable Bank. The balance did not change up to its final redemption in September 2020; however, the value relative to total investments could vary on a particular day.

Gross Debt and Capital Financing Requirement (CFR)

Gross Debt and CFR	**2020/21 Estimate £m**	**2020/21 Outturn £m**
Borrowing as at 31 March	86.969	93.469
Capital Financing Requirement as at 31 March	120.805	112.719
Amount of Borrowing (over) / under CFR	**33.836**	**19.250**

- Total borrowing at 31 March 2021 was lower than the Capital Financing Requirement (CFR) by £19.250m.
- Borrowing at 31 March 2021 was £6.500m higher than the original estimate due to some temporary borrowing taken at the year-end for short-term cashflow purposes only.
- The actual CFR at 31 March 2021 was lower than the original estimate as a result of the underspend against the capital programme for 2020/21.