

Agenda Item 7

POLICE AND CRIME COMMISSIONER FOR NORTHUMBRIA

JOINT INDEPENDENT AUDIT COMMITTEE:

15 SEPTEMBER 2014

TREASURY MANAGEMENT ANNUAL REPORT 2013/14

REPORT OF THE JOINT CHIEF FINANCE OFFICER

1. Purpose of the Report

- 1.1 The report asks the Committee to review the Treasury Management Annual Report 2013/14 as attached at Appendix A and approve for presentation to the Police and Crime Commissioner (PCC).

2. Background

- 2.1 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 2013/14.

3. Commentary

- 3.1 The Treasury Management Annual Report 2013/14 is attached at Appendix A. The key highlights are as follows:
- By actively managing our temporary investments we have maximised the interest earned and exceeded our target;
 - We have deferred some borrowing and saved money;
 - We received a further dividend payout from the Heritable Bank that has brought in more cash than anticipated.
 - We have complied with our financial regulations, prudential indicators and treasury management policy as confirmed by Internal Audit.

4. Equal Opportunities Implications

- 4.1 It is considered that there are no equal opportunities implications arising from the report.

5. Human Rights Implications

- 5.1 It is considered that there are no human rights implications arising from the report.

6 Risk Management Implications

- 6.1 This report has been prepared to report on performance against the annual Treasury Management Strategy. These are prepared with the primary aim of minimising risk to ensure that principal sums are safeguarded.

7 Financial Implications

- 7.1 All financial implications are covered in the report, there are no additional financial implications arising from the report.

8 Recommendation

- 8.1 The Committee is asked to review the Treasury Management Annual Report 2013/14 and approve for presentation to the PCC.

Treasury Management Annual Report 2013/14

The Strategy for 2013/14

1. The 2013/14 Treasury Management Policy Statement and Strategy was approved by the Joint Independent Audit Committee on 27 March 2013 for presentation to the Police and Crime Commissioner on 15 April 2013.
2. The formulation of the 2013/14 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 including prudential indicators;
 - the borrowing strategy; and
 - 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. At the time of preparing the Treasury Management Strategy, the view was that the Bank Rate would remain at 0.50% until 2014 at the earliest. Growth in the UK economy was expected to remain weak for the next two years. It is now anticipated that base rate will not be increased until 2015.

Borrowing Strategy

6. The borrowing strategy for 2013/14 was:
 - When 25 year Public Works Loans Board (PWLB) rates fell back to or below 4.10% borrowing should be considered, with preference given to terms of less than 20 years to enhance the diversity of the borrowing portfolio; and
 - Consideration was to be given to borrowing market loans which were at least 20 basis points below the PWLB target rate.
7. It was considered that there would be minimal opportunities to restructure debt however the potential for repaying debt was to be monitored throughout the year.

Treasury Management Compliance with Risk Strategy

8. The primary objective is to ensure the security of funds and minimise risks, including counterparty and interest rate risks. The internal audit report presented to the Joint Independent Audit Committee on 25 November 2013 concluded that treasury management control systems and procedures are operating well.

Outturn 2013/14 – Performance Measurement

9. 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. The outturn against the prudential indicators was reported to the Commissioner on 26 June 2014 as part of the key decisions around the capital outturn report 2013/14 confirming that all indicators were operating within agreed limits with no breaches throughout the year. For completeness a copy of the prudential indicators is attached as Appendix 1.

External Advisers

10. Capita Asset Services, Treasury Solutions 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

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

Shorter-term interest rates – During 2013/14 the Monetary Policy Committee (MPC) kept the Base Rate at 0.50% for the fifth successive year and there was no additional quantitative easing.

Longer-term interest rates – It was anticipated that the cost of borrowing in the medium and long term would increase during the year with variable, or short-term rates expected to be the cheaper form of borrowing over the period. However, the continuing uncertainties in the UK and global economies promoted a cautious approach whereby investments would continue to be dominated by low counterparty risk considerations, resulting in relatively low returns compared to borrowing rates.

Investment Performance

12. The major issue for treasury management in 2013/14 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 and the reduction in suitable counterparties, cash balances have continued to be used to temporarily fund the capital programme. This has resulted in savings on the cost of borrowing.

13. Although investment activity during the year has been restricted due to the reduced number of counterparties, continued use has been made of a range of investment instruments in order to increase flexibility, spread risk, maximise liquidity and obtain attractive interest rates. An increased use of notice reserve accounts, with high rated and UK Government supported banks has maintained the security of funds and enhanced the rate of return on investments.
14. A summary of the year's activity is shown at Appendix 2. The total interest earned in the year, excluding Heritable, was £0.268m (2012/13 £0.353m) with an average interest rate of 0.77% (2012/13 0.96%). The investment interest earned was an increase of £0.031m against the original budget of £0.237m.
15. The overall return on investments of 0.77% exceeds the accepted benchmark rate (the 7-day London Interbank Bid Rate (LIBID)) of 0.35%. 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 and exceeded our target whilst operating within the constraints of the approved Treasury Management Policy.

Heritable Bank

16. The Commissioner had a deposit of £5.2m invested in Heritable Bank, a wholly owned subsidiary of Icelandic Bank, Landsbanki, when it entered administration in October 2008. The full deposit in Heritable was due to mature by the end of 2008/09 with interest.
17. At the end of 2013/14, dividends totalling £4.983m (94.02p in the £) had been received. This is an overachievement against the estimated return of 90p in the £. As the original investment was impaired in 2010/11 to reflect the expected return, all additional income above 90p in the £ is revenue income. The additional 4.02p in the £ equates to £0.329m revenue income.
18. The most recent update from the administrators, Ernst and Young, confirmed that they do not intend to make any further distributions of dividend until the resolution of the ongoing litigation of their claim with Landsbanki.

Borrowing Performance

19. The total borrowing at 31 March 2014 was £88.131m, which was within the operational borrowing limit of £145m. This is a net increase of £12.998m from the opening figure of £75.133m, represented by £20m new borrowing and repayments of £7.002m. The new borrowing was taken as follows:

Date	Term (years)	Amount	Interest Rate	Source
04/04/2013	1.50	£5.000m	0.60%	Market Loan
01/05/2013	0.50	£5.000m	0.35%	Market Loan
02/05/2013	3.00	£5.000m	1.05%	Market Loan
02/05/2013	10.00	£5.000m	2.52%	PWLB
		£20.000m		

20. At 31 March 2014, £73.131m of the total borrowing was from the PWLB with the remaining £15m taken from market loans.
21. The overall revenue cost of borrowing in 2013/14 was £3.508m. This was £0.420m less than the budget. The saving was mainly due to the decision to delay borrowing by temporarily funding the capital programme from cash balances and the reduction in long term interest rates.

Debt Restructuring and Repayment

22. 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 outweighed any savings and therefore there was no early redemption or restructuring of debt.

Summary of Treasury Management performance for the year 2013/14

23. Investment income, excluding the additional dividend relating to the Heritable Bank, was £0.031m more than the budget. The increase in investment interest was due to the use of cash reserves being less than anticipated. This overachievement in investment income increased to £0.360m with the addition of the Heritable Bank dividend.
24. Borrowing costs were £0.420m less than the budget, mainly due to a reduction in the borrowing taken compared to the estimate.
25. Overall Treasury Management performance against budget for 2013/14 generated savings of £0.451m, which increased to £0.780m including Heritable and is summarised in the following table:

	Budget	2013/14 Actual	Saving
	£m	£m	£m
Cost of Borrowing	3.928	3.508	(0.420)
Investment Income	(0.237)	(0.597)	(0.360)
Net Position	3.691	2.911	(0.780)

Prudential Indicators 2013/14

Authorised Limit for External Debt		
	2013/14 £000 Reported Indicator	2013/14 £000 Outturn
Borrowing	170,000	88,131
Other Long Term Liabilities	0	0
Total	170,000	88,131
Maximum YTD £95.132m		

Operational Boundary for External Debt		
	2013/14 £000 Reported Indicator	2013/14 £000 Outturn
Borrowing	145,000	88,131
Other Long Term Liabilities	0	0
Total	145,000	88,131
Maximum YTD £95.132m		

Limit on Fixed and Variable Interest Rates Exposures		
Range	2013/14 £000 Reported Indicator	2013/14 £000 Outturn
Fixed Rate	85,206 (20,617)	69,462 <i>max 85,018</i> <i>min 42,506</i>
Variable	12,750 (20,000)	0,000 <i>max 0,000</i> <i>min (16,317)</i>
All within agreed limits (Max and Min YTD)		

Upper / Lower Limits for Maturity Structure of Fixed Rate Borrowing				
	2013/14 Reported Indicator		2013/14 Outturn	
	Upper Limit	Lower Limit	Actual Percentage	Maximum YTD
Under 12 months	20%	0%	19.10%	19.10%
12 months to 24 months	40%	0%	5.48%	21.01%
24 months to 5 years	60%	0%	28.93%	32.56%
5 years to 10 years	70%	0%	22.69%	27.83%
10 years and above	90%	0%	23.79%	26.17%
All within agreed limits				

Upper Limit on amounts invested beyond 364 days			
	2013/14 £000 Reported Indicator	2013/14 £000 Outturn	2013/14 £000 Maximum YTD
	Investments	15,000	0

Investment Activity

Investments maturing during the year		
	2012/13	2013/14
Number of investments made in 2011/12 maturing in 2012/13	12	n/a
Number of investments made in 2012/13 maturing in 2012/13	803	n/a
Number of investments made in 2012/13 maturing in 2013/14	n/a	7
Number of investments made in 2013/14 maturing in 2013/14	n/a	464
Total number of investments maturing in year	815	471
Number of investments made in 2013/14 maturing in 2014/15	n/a	0

Average duration of investments		
	2012/13	2013/14
Average duration of investments (including overnight)	6 days	6 days
Average duration of investments (excluding overnight)	80 days	50 days

Summary of non-specified investments		
	2012/13	2013/14
Non-specified investments:		
Rated non-high		
Approved limit	55%	55%
Maximum level invested	23%	27%
Not Rated		
Approved limit	0%	0%
Maximum level invested*	8%	11%
Investments over 364 days		
Approved limit	20%	20%
Maximum level invested	0%	0%

*Relates to local authority investments greater than 364 days and the impaired investment with Heritable Bank.