**POLICE AND CRIME COMMISSIONER FOR NORTHUMBRIA**

**JOINT INDEPENDENT AUDIT COMMITTEE**

**14 SEPTEMBER 2015**

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# TREASURY MANAGEMENT ANNUAL REPORT 2014/15

**REPORT OF THE JOINT CHIEF FINANCE OFFICER**

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## 1. Purpose of the Report

1.1 The report presents the Treasury Management Annual Report 2014/15 as attached at Appendix A and seeks approval 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 2014/15.

## 3 Commentary

3.1 The Treasury Management Annual Report 2014/15 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 and the delay in borrowing being taken by using existing cash resources

- Investment income was under budget reflecting average investments being well below the estimate at the start of the year due to the profile of income being received and the delay in taking borrowing. Investment rates were also less than budgeted.

- 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 2014/15 and approve for presentation to the PCC.

# Treasury Management Annual Report 2014/15

## The Strategy for 2014/15

1. The 2014/15 Treasury Management Policy Statement and Strategy was approved by the Joint Independent Audit Committee on 24 February 2014 for presentation to the Police and Crime Commissioner on 03 March 2014.

2. The formulation of the 2014/15 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 annual strategy, the original market expectation at the beginning of 2014/15 was for the first increase in the Bank of England Base Rate to occur in the first quarter of 2014. In May, however, the Bank revised its forward guidance and it was noted that the Monetary Policy Committee would have great difficulty in starting to raise the base rate in 2015 while inflation was around zero and so market expectations for the first increase receded back to around quarter 3, 2016.

## Borrowing Strategy

6. The borrowing strategy for 2014/15 was:

    - When 25 year Public Works Loans Board (PWLB) rates fell back to or below 4.55% 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 using market loans which were at least 20 basis points below the PWLB target rate.

7. The early repayment of debt was determined to achieve poor value during 2014/15 as the cost of premiums on the early repayment of debt was too high.

**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. An Internal Audit review of the treasury management function in 2014/15 gave the opinion that it was 'Operating Well'.

**Outturn 2014/15 – 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 18th June 2015 as part of the key decisions around the capital outturn report 2014/15 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 2014/15 the Monetary Policy Committee (MPC) kept the Base Rate at 0.50% for the sixth 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 2014/15 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 and reduced credit risk as the investment portfolio has reduced.

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, was £0.123m (2013/14 £0.268m) with an average interest rate of 0.46% (2013/14 0.77%).The investment interest earned was an decrease of £0.064m against the original budget of £0.187m.

15. The overall return on investments of 0.46% 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 2014/15, 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, in May 2015, provided notice of another dividend which is anticipated to be declared and paid in August 2015. The estimated return is revised upwards to 98 to 100 pence in the pound.

**Borrowing Performance**

19. The total borrowing at 31 March 2015 was £96.297m, which was within the operational borrowing limit of £145m.This is a net increase of £8.166m from the opening figure of £88.131m, represented by £36.350m new borrowing and repayments of £28.184m. The new borrowing was taken as follows:

| Date | Term (years) | Amount | Interest Rate | Source |
|---|---|---|---|---|
| 25/04/2014 | 0.50 | £8.000m | 0.35% | Market Loan |
| 02/05/2014 | 1.00 | £5.000m | 0.50% | Market Loan |
| 01/07/2014 | 0.02 | £2.000m | 0.27% | Market Loan |
| 08/01/2015 | 0.02 | £1.350m | 0.40% | Market Loan |
| 09/01/2015 | 0.04 | £5.000m | 2.79% | PWLB |
| 09/01/2015 | 0.10 | £5.000m | 3.16% | PWLB |
| 02/03/2015 | 1.00 | £10.000m | 0.65% | Market loan |
| | | **£36.350m** | | |

20. At 31 March 2015, £71.297m of the total borrowing was from the PWLB with the remaining £25m taken from market loans.

21. The overall revenue cost of borrowing in 2014/15 was £3.486m. This was £0.271m less than the budget. The saving was mainly due to the decision to delay borrowing by temporarily funding the capital programme and borrowing being taken at lower rates than estimated.

**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 2014/15**

23. Investment income was £0.064m under budget. The under achievement reflects average investments being well below the estimate at the start of the year due to the profile of income being received and the delay in taking borrowing. Investment interest rates received throughout the year were also below budgeted rates.

24. Borrowing costs were £0.271m less than the budget This is due to borrowing being taken at lower rates than estimated and the delay in borrowing being taken

25. Overall Treasury Management performance against budget for 2014/15 generated a surplus of £0.207m as summarised in the following table:

| | | **2014/15** | |
|---|---|---|---|
| | **Budget £m** | **Actual £m** | **Saving £m** |
| Cost of Borrowing | 3.757 | 3.486 | (0.271) |
| Investment Income | (0.187) | (0.123) | 0.064 |
| **Net Position** | **3.570** | **3.363** | **(0.207)** |

## Prudential Indicators 2014/15

| Authorised Limit for External Debt | |
|---|---|
| | **2014/15<br>£000<br>Reported Indicator** |
| Borrowing | 170,000 |
| Other Long Term Liabilities | 0 |
| **Total** | **170,000** |
| Maximum YTD £103.131m | |

| *Operational Boundary for External Debt* | |
|---|---|
| | **2014/15<br>£000<br>Reported Indicator** |
| Borrowing | 145,000 |
| Other Long Term Liabilities | 0 |
| **Total** | **145,000** |
| Maximum YTD £103.131m | |

| Limit on Fixed and Variable Interest Rates Exposures | | |
|---|---|---|
| **Range** | **2014/15<br>£000<br>Reported Indicator** | **2014/15<br>£000<br>Outturn** |
| Fixed Rate | 116,789<br>(10,410) | 96.297<br>*max 96,297*<br>*min 39,320* |
| Variable | 6,707<br>(20,000) | 0,000<br>*max 0,000*<br>*min (0.000)* |
| All within agreed limits<br>(Max and Min YTD) | | |

| Upper / Lower Limits for Maturity Structure of Fixed Rate Borrowing | | | | |
|---|---|---|---|---|
| | **2014/15 Reported Indicator** | | **2014/15 Outturn** | |
| | **Upper Limit** | **Lower Limit** | **Actual Percentage** | **Maximum YTD** |
| < 1yr | 50% | 0% | 20.59% | 30.04% |
| 1 -2 yrs | 50% | 0% | 15.58% | 18.69% |
| 2 – 5 yrs | 60% | 0% | 16.09% | 29.54% |
| 5 – 10yrs | 70% | 0% | 20.77% | 23.18% |
| 10 yrs > | 90% | 0% | 26.97% | 26.97% |
| All within agreed limits | | | | |

| Upper Limit on amounts invested beyond 364 days | | | |
|---|---|---|---|
| | **2014/15 £000 Reported Indicator** | **2014/15 £000 Outturn** | **2014/15 £000 Maximum YTD** |
| Investments | **15,000** | **0** | **0** |

## Investment Activity

| **Investments maturing during the year** | **2013/14** | **2014/15** |
|---|---|---|
| Number of investments made in 2012/13 maturing in 2013/14 | 7 | n/a |
| Number of investments made in 2013/14 maturing in 2013/14 | 464 | n/a |
| Number of investments made in 2013/14 maturing in 2014/15 | 0 | 0 |
| Number of investments made in 2014/15 maturing in 2014/15 | n/a | 544 |
| Total number of investments maturing in year | **471** | **544** |
| Number of investments made in 2014/15 maturing in 2015/16 | n/a | 0 |

| **Average duration of investments** | **2013/14** | **2014/15** |
|---|---|---|
| Average duration of investments (including overnight) | 6 days | 2 days |
| Average duration of investments (excluding overnight) | 50 days | 72 days |

| **Summary of non-specified investments** | **2013/14** | **2014/15** |
|---|---|---|
| **Non-specified investments:** | | |
| Rated non-high | | |
| Approved limit | 55% | 55% |
| Maximum level invested | 27% | 53% |
| Not Rated | | |
| Approved limit | 0% | 0% |
| Maximum level invested* | 11% | 8% |
| Investments over 364 days | | |
| Approved limit | 20% | 20% |
| Maximum level invested | 0% | 0% |

*Relates to impaired investment with Heritable Bank.