NORTHUMBRIA POLICE AND CRIME COMMISSIONER

Key Decisions

Title and Reference - (PCC/242/2016)

Treasury Management Annual Report 2015/16

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 2015/16.

The report was reviewed by the Joint Independent Audit Committee at their meeting on 12 September 2016.

Recommendation/ Findings:

To approve the Treasury Management Annual Report 2015/16.

Northumbria Police and Crime Commissioner

I hereby approve the recommendation above.

Signature **Date 22.09.16**

TREASURY MANAGEMENT ANNUAL REPORT 2015/16

REPORT OF JOINT CHIEF FINANCE OFFICER

1. PURPOSE OF THE REPORT

1.1 To approve the Treasury Management Annual Report 2015/16 as attached at Appendix A.

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 2015/16.

2.2 The annual report was reviewed by the Joint Independent Audit Committee at their meeting on 12 September 2016.

3. SUMMARY

3.1 The Treasury Management Annual Report 2015/16 is attached at Appendix A. The key highlights are as follows:

- We saved money by refinancing our borrowing requirements with short term loans which were at lower interest rates than long term loans.

- We received more interest from investments because we made more investments at a higher average interest rate than anticipated when the budget was set.

- We also received a further unexpected dividend distribution from the Heritable Bank.

- We have followed financial regulations, monitored the prudential indicators and adhered to the treasury management policy.

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 Policy and Strategy which has the primary objective to ensure the security of funds and minimise risks, including counterparty and interest rate risks.

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 To approve the Treasury Management Annual Report 2015/16.

Appendix A

Treasury Management Annual Report 2015/16

The Strategy for 2015/16

1. The 2015/16 Treasury Policy and Strategy was approved by the Joint Independent Audit Committee on 23 February 2015 for presentation to the Police and Crime Commissioner and it was approved as a key decision on 26 February 2015.

2. The formulation of the 2015/16 Treasury 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. The expectation for interest rates within the treasury management strategy for 2015/16 anticipated a low but increasing base rate, (starting in quarter 1 of 2016), and gradual rises in medium and longer term fixed borrowing rates during 2016/17. However during 2015/16 the Bank of England Monetary Policy Committee (MPC) kept the Base Rate at 0.50% for the seventh successive year and borrowing rates remained at record low levels. Variable, or short-term rates, were expected to be the cheaper form of borrowing over the period. Continued uncertainty in the aftermath of the 2008 financial crisis 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.

6. In this scenario, the treasury strategy was to postpone borrowing to avoid the cost of holding higher levels of investments and to reduce counterparty risk.

Borrowing Strategy

7. The borrowing strategy for 2015/16 was:

    - When PWLB rates fall back to or below Capita Asset Services trigger rates borrowing should be considered, with preference given to terms of less than 20 years to enhance the diversity of the borrowing portfolio.

    - Consideration was to be given to borrowing using market loans which were at least 20 basis points below the PWLB target rate.

8. The early repayment of debt was determined to achieve poor value during 2015/16 as the cost of premiums on the early repayment of debt was too high.

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 2015/16 gave the opinion that it was 'Operating Well'.

Outturn 2015/16 – 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. The outturn against the prudential indicators was reported to the Commissioner on 9 June 2016 as part of the key decisions around the capital outturn report 2015/16 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

11. 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

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

    Shorter-term interest rates – During 2015/16 the MPC kept the Base Rate at 0.50% for the seventh successive year and there was no additional quantitative easing.

    Longer-term interest rates – Market expectations for the first increase in Bank Rate moved considerably during 2015/16, starting at quarter 3 2015 but soon moving back to quarter 1 2016. However, by the end of the year, market expectations had moved back radically to quarter 2

2018 due to many fears including concerns that China's economic growth could be heading towards a hard landing; the potential destabilisation of some emerging market countries particularly exposed to the Chinese economic slowdown; and the continuation of the collapse in oil prices during 2015 together with continuing Eurozone growth uncertainties.

Investment Performance

13. The major issue for treasury management in 2015/16 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.

14. 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 money market funds, 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.

15. A summary of the year's activity is shown at Appendix 2. The total interest earned in the year, was £0.349m (2014/15 £0.123m) with an average interest rate of 0.49% (2014/15 0.46%). The total interest earned is made up of £0.139m investment income and a Heritable Bank dividend of £0.211m that was received in August 2015 (more information below). The investment interest earned was an increase of £0.054m against the original budget of £0.085m.

16. The overall return on investments of 0.49% exceeded the accepted benchmark rate (the 7-day London Interbank Bid Rate (LIBID)) of 0.36%. 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

17. 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.

18. At the end of 2015/16, dividends totalling £5.194m (98.00p 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 8.00p in the £ equates to £0.540m revenue income.

19. The most recent update from the administrators, Ernst and Young, in March 2016, provided detail of all dividends received to date and advised that no further dividend is expected at the current time until the current administration period closes on the 6th October 2016.

Borrowing Performance

20. The total borrowing at 31 March 2016 was £104.465m, which was within the operational borrowing limit of £145m.This is a net increase of £8.166m from the opening figure of £96.297m, represented by £49.000m new borrowing and repayments of £40.832m. The new borrowing was taken as follows:

Date	Term (years)	Amount	Interest Rate	Source
02/04/2015	1.51	£5.000m	0.75%	Market Loan
02/04/2015	1.51	£5.000m	0.75%	Market Loan
30/04/2015	0.50	£5.000m	0.48%	Market Loan
29/04/2015	0.25	£5.000m	0.40%	Market Loan
29/04/2015	0.02	£3.000m	0.30%	Market Loan
01/06/2015	0.10	£5.000m	0.33%	Market Loan
29/06/2015	0.01	£3.000m	0.35%	Market Loan
07/01/2016	0.50	£4.000m	0.55%	Market Loan
07/01/2016	0.50	£2.000m	0.50%	Market Loan
01/03/2016	0.25	£3.000m	0.50%	Market Loan
01/03/2016	0.35	£9.000m	0.55%	Market Loan
		£49.000m		

21. The borrowing strategy during 2015/16 was to keep borrowing short term as the Commissioner is in the process of rationalising the estate and is expecting over £30m of receipts from the sale of assets in the future. This strategy has produced one-off revenue budget savings due to the actual interest payable on short term loans is lower than long term loans. Whilst this carried the risk that longer term rates could rise at the time that situation has now changed.

22. The average borrowing interest rate at 31 March 2016 was 3.45% compared to 4.28% at 31 March 2015. This reflects the short term/low interest rate borrowing taken in 2015/16. This delivered savings but carried at the time a potential interest rate risk should rates increase when re-financing (this is now not the case as the Bank of England cut the bank base rate to 0.25% in August 2016).

23. The strategy resulted in the overall interest cost of borrowing of £3.459m which was £0.479m less than the budget.

24. At 31 March 2016, £66.465m of the total borrowing was from the PWLB with the remaining £38m taken from market loans.

Debt Restructuring and Repayment

25. 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 2015/16

26. Investment income was £0.349m over budget. This comprises an additional dividend received for Heritable Bank of £0.211m and a further £0.053m investment income due to more investments at a higher interest rate than anticipated when the budget was set.

27. Borrowing costs were £0.479m less than the budget. This is due to borrowing being taken at lower rates than estimated and the delay in long term borrowing being taken.

28. Overall Treasury Management performance against the budget for 2015/16 generated a surplus of £0.743m as summarised in the following table:

2015/16 Summary of Treasury Management Performance

	Budget £m	Actual £m	Saving £m
Cost of Borrowing	3.938	3.459	(0.479)
Investment Income	(0.085)	(0.138)	(0.053)
Heritable Dividend	0.000	(0.211)	(0.211)
Net Position	**3.853**	**3.110**	**(0.743)**

Prudential Indicators 2015/16

Authorised Limit for External Debt	
	2015/16 **£000** **Reported Indicator**
Borrowing	170,000
Other Long Term Liabilities	0
Total	**170,000**
Maximum YTD £119.297m	

Operational Boundary for External Debt	
	2015/16 **£000** **Reported Indicator**
Borrowing	145,000
Other Long Term Liabilities	0
Total	**145,000**
Maximum YTD £119.297m	

Limit on Fixed and Variable Interest Rates Exposures		
Range	**2015/16** **£000** **Reported Indicator**	**2015/16** **£000** **Outturn**
Fixed Rate	110.425 (7.535)	98.700 *max 112.332* *min 51.002*
Variable	6.000 (20.000)	1.200 *max 0,000* *min (8.000)*
PCC breached the upper fixed rate limit for one week in quarter 1 due to decreasing investments held resulting from estimated profile of capital receipts not materialising. This rectified itself when the Pension Top up grant was received on the 3rd July. This breach was reported to the Quarter 1 Joint Finance Meeting on the 25th August 2015 and recorded as a key decision on the PCC website.		

Upper / Lower Limits for Maturity Structure of Fixed Rate Borrowing				
	2015/16 Reported Indicator		**2015/16 Outturn**	
	Upper Limit	**Lower Limit**	**Actual Percentage**	**Maximum YTD**
< 1yr	50%	0%	41.16%	41.72%
1 -2 yrs	40%	0%	4.38%	23.52%
2 – 5 yrs	40%	0%	10.45%	15.58%
5 – 10yrs	70%	0%	19.15%	21.63%
10 yrs >	90%	0%	24.86%	28.09%
All within agreed limits				

Upper Limit on amounts invested beyond 364 days			
	2015/16 £000 Reported Indicator	**2015/16 £000 Outturn**	**2015/16 £000 Maximum YTD**
Investments	**15,000**	**0**	**0**

Investment Activity

Investments maturing during the year	2014/15	2015/16
Number of investments made in 2013/14 maturing in 2014/15	0	n/a
Number of investments made in 2014/15 maturing in 2014/15	544	n/a
Number of investments made in 2014/15 maturing in 2015/16	n/a	0
Number of investments made in 21015/16 maturing in 2015/16	n/a	750
Total number of investments maturing in year	**471**	**750**
Number of investments made in 2015/16 maturing in 2016/17	n/a	0

Average duration of investments	2014/15	2015/16
Average duration of investments (including overnight)	2 days	2 days
Average duration of investments (excluding overnight)	72 days	88 days

Summary of non-specified investments	2014/15	2015/16
Non-specified investments:		
Rated non-high		
Approved limit	55%	55%
Maximum level invested	53%	63%**
Not Rated		
Approved limit	0%	0%
Maximum level invested*	8%	6%
Investments over 364 days		
Approved limit	20%	20%
Maximum level invested	0%	0%

*Relates to impaired investment with Heritable Bank.
**Relates to a breach of one week only due to a deposit placed prior to an unforeseen change in ratings for Lloyds bank mid-week from a Government backed Bank to a Non-Government backed Bank.