

NORTHUMBRIA POLICE AND CRIME COMMISSIONER

Key Decision

Treasury Management Annual Report 2017/18.

(PCC/339/2018)

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 2017/18.

The report was reviewed by the Joint Independent Audit Committee at their meeting on 23 July 2018.

Recommendation

To approve the Treasury Management Annual Report as a true record of activities for financial year 2017/18.

Northumbria Police and Crime Commissioner

I hereby approve the recommendations above.

Signature



Date 6th September 2018

OPCC BUSINESS MEETING	06 SEPTEMBER 2018
TREASURY MANAGEMENT ANNUAL REPORT 2017/18	
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 (PCC) the Treasury Management Annual Report for the financial year 2017/18, for review and acceptance.

2. RECOMMENDATIONS

- 2.1 The Police and Crime Commissioner is asked to:
- a) Review the attached Treasury Management Annual Report 2017/18.
 - b) Accept it as a true record of the activities for 2017/18.

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 this requirement and informs the Commissioner of Treasury Management activity during 2017/18.
- 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 23 July 2018.
- 3.3 It is also worthy of note, during the year responsibility for Treasury Management was transferred from Gateshead Council to Northumbria Police Finance Department. The transfer took place on 3 January 2018 and therefore this report covers the period 1 April 2017 to 2 January 2018 under Gateshead Council, and 3 January 2018 to 31 March 2018 under Northumbria Police.

4. KEY OUTCOMES

- 4.1 The Treasury Management Annual Report 2017/18 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 deference in external borrowing being taken by using existing internal cash resources.

- Investment income received was higher than budget, reflecting the increase in the base rate in November 2017, increasing returns on investments.
- We have complied with our financial regulations and all prudential indicators were within the limits set for the year.

5. CONSIDERATIONS

Government Protective Marking Scheme	NOT PROTECTIVELY MARKED
Freedom of Information	NON-EXEMPT
Consultation	Yes
Joint Independent Audit Committee on 23 July 2018	
Resource	No
Equality	No
Legal	No
Risk	No
Communication	No
Evaluation	No

Treasury Management Annual Report 2017/18

The Strategy for 2017/18

1. The 2017/18 Treasury Management Policy Statement and Strategy was approved by the Joint Independent Audit Committee on 27 February 2017 for presentation to the Police and Crime Commissioner (PCC). The key decision was approved by the PCC on 09 March 2017.
2. The formulation of the 2017/18 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 2017/18 anticipated the Bank Rate being maintained at 0.25% during the 2-year period to March 2019, during which time the UK would be negotiating terms for withdrawal from the EU. Tentative increases of 0.25% were forecast in both quarter 2 and quarter 3 for 2019/20 bringing forecast the Bank Rate to 0.75% by December 2019. The Strategy noted the potential for the pace and timing of increases in Bank Rate to be brought forward, particularly if domestically generated inflation (e.g. from UK wage increases), were to emerge.
6. The Treasury Management Strategy was to adopt caution in the management of the 2017/18 treasury operations. The interest rate market was monitored to allow the CFO to adopt a pragmatic approach to any changing circumstances, having delegated powers to invest and manage the funds and monies of the Commissioner.

7. During 2017/18, longer term PWLB rates were volatile but with little overall direction, whereas shorter term PWLB rates were on a rising trend during the second half of the year.

Borrowing Strategy

8. The borrowing strategy for 2017/18 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.
 - Utilise 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 cost savings with the mitigation of refinancing risks.
9. The early repayment of debt was not considered to present value for money during 2017/18, 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

10. 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 November 2017 gave the opinion that it was 'Operating Well'.

Outturn 2017/18 – Performance Measurement

11. 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.
12. There was one occasion of the exceedance of the combined Money Market Fund (MMF) investment limit of £25.000m in January 2018. Whilst individual fund balances were within limits set by individual counterparty, the total across the 5 MMFs was above the combined limit set out in the Investment Strategy Statement. The largest daily MMF investment across that period was £27.910m. The issue arose due to surplus funds being available as a result of additional borrowing taken at the start of the month to provide financial resilience during the first month of the in-house service provision. An

additional process was added to the daily banking assessment to show all individual and group counterparty balances and highlight any potential exceedance before investment transfers are authorised.

External Advisers

13. Link Asset Services (previously Capita 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.

Market Interest Rates

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

- **Shorter-term interest rates**

On 2 November 2017 the Bank Rate was raised from 0.25% to 0.50% and stayed at that level for the remainder of the year. Market expectations for increases in Bank Rate shifted considerably during the second half of 2017-18 and resulted in investment rates from 3 – 12 months increasing sharply during the spring quarter.

- **Longer-term interest rates**

During the 2017 calendar year there was a major shift in expectations in financial markets in terms of how soon Bank Rate would start on a rising trend. Market expectations that the MPC would be heading in the direction of imminently raising Bank Rate rose significantly in the autumn, following modest UK economic growth during the second half of 2017. The minutes of the MPC meeting of 14 September indicated that the MPC was likely to raise Bank Rate very soon. The 2 November MPC quarterly Inflation Report meeting duly delivered by raising Bank Rate from 0.25% to 0.50%.

The 8 February MPC meeting minutes then revealed another sharp hardening in MPC warnings on a more imminent and faster pace of increases in Bank Rate than had previously been expected.

PWLB borrowing rates increased correspondingly to the above developments with the shorter term rates increasing more sharply than longer term rates. The 50 year PWLB target (certainty) rate for new long term borrowing was 2.50% in quarters 1 and 3 and 2.60% in quarters 2 and 4.

Investment Performance

15. The main focus for treasury management in 2017/18 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 savings on the cost of borrowing and reduced credit risk as the investment portfolio has reduced.

16. 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.
17. A summary of the year's activity is shown at Appendix 2. The total interest earned in the year, was £0.048m (2016/17 £0.078m) with an average interest rate of 0.31% (2016/17 0.43%). The investment interest earned was an increase of £0.019m against the original budget of £0.029m. The increase in Bank Rate from 0.25% to 0.50% on 2 November 2017 helped boost investment returns in the last 5 months of the financial year.
18. The overall return on investments of 0.31% exceeds the accepted benchmark rate (the 7-day London Interbank Bid Rate (LIBID)) of 0.18%. 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.

Heritable Bank

19. The former Police Authority had a deposit of £5.238m 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.
20. As at 31 March 2018, total dividends of £5.194m (98.00p in the £) have been received, reflecting no further dividend in 2017/18. The balance of the investment sum outstanding is therefore £0.044m.
21. The most recent update from the administrators, Ernst and Young, in March 2018, confirmed the detail of all dividends received to date and advised that no further dividend is expected until the administrators conclude their work. Ernst and Young intend to report further on this matter during 2018/19.

Borrowing Performance

22. The total borrowing at 31 March 2018 was £106.885m, which was within the operational borrowing limit of £145.000m. This is a net increase of £7.420m from the opening balance of £99.465m, represented by £82.000m new borrowing and repayments of £74.580m. The new borrowing was taken as follows:

Date	Term	Amount	Interest Rate	Source
03/04/2017	24 days	£4.000m	0.50%	Market Loan
13/04/2017	85 days	£5.000m	0.35%	Market Loan
21/04/2017	77 days	£5.000m	0.35%	Market Loan
24/04/2017	74 days	£5.000m	0.30%	Market Loan
02/05/2017	66 days	£4.000m	0.30%	Market Loan
02/05/2017	66 days	£1.500m	0.30%	Market Loan
02/05/2017	66 days	£1.500m	0.30%	Market Loan
01/06/2017	34 days	£3.000m	0.20%	Market Loan
03/07/2017	7 days	£1.000m	0.17%	Market Loan
22/11/2017	226 days	£6.000m	0.58%	Market Loan
22/11/2017	226 days	£2.000m	0.58%	Market Loan
22/11/2017	226 days	£2.000m	0.58%	Market Loan
22/12/2017	196 days	£10.000m	0.62%	Market Loan
03/01/2018	184 days	£10.000m	0.62%	Market Loan
31/01/2018	8 days	£6.000m	0.40%	Market Loan
28/02/2018	7 days	£3.000m	0.50%	Market Loan
28/02/2018	16 days	£3.000m	0.55%	Market Loan
31/08/2017	48 years	£5.000m	2.30%	PWLB
22/03/2018	46.5 years	£5.000m	2.33%	PWLB
Total		£82.000m		

23. The use of reserve and General Fund balances to limit the requirement for new borrowing has continued to deliver savings in 2017/18, reducing investment balances rather than increasing external borrowing in order to minimise interest costs.
24. The average borrowing interest rate at 31 March 2018 was 3.29% compared to 3.45% at 31 March 2017. This reflects the short term/low rate borrowing taken in 2017/18, the repayment of PWLB loans at higher interest rates and new PWLB borrowing secured at low rates of 2.30% / 2.33%.
25. The use of temporary short term borrowing is delivering savings in the short term but carries potential interest rate risk, if rates rise and there is a requirement to re-finance.
26. At 31 March 2018, £71.885m of the total borrowing was from the PWLB with the remaining £35.000m taken from market loans.
27. The overall revenue cost of borrowing in 2017/18 was £2.991m. This was £0.138m less than the budget. Forecast new PWLB borrowing was secured at rates lower than budget, and despite the increase in the Bank Rate in November 2017 average short term rates have remained within the budget set at 0.6%.

Debt Restructuring and Repayment

28. 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 2017/18

29. Investment income was £0.019m over budget reflecting the increase in base rate in November 2017 increasing the return on investments.
30. Borrowing costs were £0.138m less than the budget. Despite the increase in the Bank of England base rate in November 2017, average short term temporary borrowing rates have remained within the budget set at 0.6%. 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 2017/18 generated a saving of £0.157m as summarised in the following table:

	2017/18 Budget £m	2017/18 Actual £m	2017/18 Saving £m
Cost of Borrowing	3.129	2.991	(0.138)
Investment Income	(0.029)	(0.048)	(0.019)
Net Position	3.100	2.943	(0.157)

Prudential Indicators 2017/18

Authorised Limit for External Debt		
	2017/18 Reported Indicator £m	2017/18 Maximum YTD £m
Borrowing	170.000	114.465
Other Long Term Liabilities	0.000	0.000
Total	170.000	114.465

Operational Boundary for External Debt		
	2017/18 Reported Indicator £m	2017/18 Maximum YTD £m
Borrowing	145.000	114.465
Other Long Term Liabilities	0.000	0.000
Total	145.000	114.465

Limit on Fixed and Variable Interest Rates Exposure				
	2017/18 Reported Indicator £m		2017/18 Outturn £m	
Fixed Rate	Max	129.465	Actual Max	98.020 112.070
	Min	(13.561)	Min	38.963
Variable	Max	9.446	Actual Max	0.000 0.000
	Min	(20.000)	Min	(10.000)
All within agreed limits (Max and Min YTD)				

Upper / Lower Limits for Maturity Structure of Fixed Rate Borrowing				
	2017/18 Reported Indicator		2017/18 Outturn	
	Upper Limit	Lower Limit	Actual Percentage	Maximum YTD
< 1yr	70.00%	0.00%	33.60%	41.57%
1 – 2 yrs.	60.00%	0.00%	4.68%	7.00%
2 – 5 yrs.	60.00%	0.00%	4.68%	7.00%
5 – 10 yrs.	65.00%	0.00%	9.36%	20.99%
10 yrs. >	80.00%	0.00%	47.68%	63.95%
All within agreed limits				

Upper Limit on amounts invested beyond 364 days			
	2017/18 Reported Indicator £m	2017/18 Outturn £m	2017/18 Maximum YTD £m
	Investments	15.000	0

Investment Activity

Investments maturing during the year		
	2016/17	2017/18
Number of investments made in the previous year, maturing in the reporting year	1	0
Number of investments made in the reporting year, maturing in the reporting year	1,245	651
Total number of investments maturing in the reporting year	1,246	651
Number of investments made in reporting year, maturing in the following year	0	0

Average duration of investments		
	2016/17	2017/18
Average duration of investments (including overnight)	1 day	1 day
Average duration of investments (excluding overnight)	47 days	52 days

Summary of non-specified investments		
	2016/17	2017/18
Non-specified investments:		
Rated non-high		
Approved limit	75%	75%
Maximum level invested	23%	0%
Not Rated		
Approved limit	0%	0%
Maximum level invested*	6%	29%
Investments over 364 days		
Approved limit	20%	20%
Maximum level invested	0%	0%

*The *Not Rated* investment relates to the impaired balance with Heritable Bank. The balance has not changed over the 2 year period shown, however its value relative to total investments can vary on any particular day. The 29% level represents the position on 4 July 2017 when overall investment balances were only £0.152m, prior to receipt of the Home Office pension top-up grant the following day.

Gross Debt and Capital Financing Requirement (CFR)

Gross Debt and CFR	2017/18 Estimate £m	2017/18 Outturn £m
Borrowing as at 31 March	101.885	106.885
Capital Financing Requirement as at 31 March	102.244	101.387
Amount of Borrowing (over) / under CFR	0.359	(5.498)

Actual borrowing as at 31 March 2018 is above CFR by £5.498m. This relates to short term temporary borrowing taken at the year end to cover the cash flow position and anticipated working capital deficit. In addition the borrowing is within the CFR estimates projected for the next two years to 2019/20, in line with the Code of Practice.

2.