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| **OFFICE OF THE POLICE & CRIME COMMISSIONER****OFFICE OF THE CHIEF CONSTABLE** |
| **TITLE:** | **Treasury Management Annual Report 2022/23** |
| **DATE:** | **15th June 2023** |
| **TIMING:** | **Routine** |
| **PURPOSE:** | **For consideration** |
| **1.** | **RECOMMENDATION** |
| 1.1 | That the Annual Treasury Management Activity Report and actual Prudential Indicators for 2022/23 are approved. |
| **2.** | **INTRODUCTION & BACKGROUND** |
| 2.12.22.32.42.5 |  Treasury Management is the management of cash flows, banking, money market and capital market transactions and the management of the associated risks, in the pursuit of the optimum performance or return consistent with those risks.1.2 The Treasury Management Annual Report is a requirement of the Police and Crime Commissioner’s (PCC’s) statutory reporting responsibilities.The report meets the requirements of both the Chartered Institute of Public Finance and Accountancy’s (CIPFA) Code of Practice on Treasury Management and the CIPFA Prudential Code for Capital Finance in Local Authorities. The PCC is required to comply with both Codes through Regulations issued under the Local Government Act 2003.The report covers both Treasury Management activity during 2022/23 and the actual Prudential Indicators for 2022/23.During 2022/23 the minimum reporting requirements were that the PCC received an annual treasury management strategy in advance of the year, a mid-year update report and an annual report following the year end, describing the actual performance or activity compared to the annual strategy. |
| **3.** | **ISSUES FOR CONSIDERATION** |
| **3.1** | **Capital Expenditure and Financing** |
| 3.1.13.1.2 | During each financial year the PCC incurs expenditure on acquiring and enhancing land, buildings, vehicles and other long term assets. These activities are known as capital expenditure. Such expenditure may either be:1. Financed immediately through the application of capital or revenue resources (capital receipts, capital grants, revenue contributions etc.), which has no resultant impact on borrowing need; or
2. If insufficient financing is available, or a decision is taken not to apply resources, the capital expenditure will give rise to a borrowing need.

 Actual capital expenditure forms one of the required Prudential Indicators. The table below shows capital expenditure in the respective years and how this was financed. The 2022/23 Estimate of capital expenditure is as per the Treasury Management Strategy for 2022/23.

|  |  |  |  |
| --- | --- | --- | --- |
|   | 2021/22 | 2022/23 | 2022/23 |
|   | Actual | Estimate | Actual |
|   | £m | £m | £m |
|   |  |  |  |
| **Capital Expenditure** | 17.285 | 17.944 | 7.463 |
|   |  |  |  |
| Financed by: |  |  |  |
| Capital Receipts | 2.498 | 0.210 | 0 |
| Capital Grants and PIF Grants | 0.120 | 0.120 | 0 |
| Reserves | 7.288 | 6.580 | 0.994 |
| Revenue | 7.379 | 7.179 | 6.469 |
|   |  |  |  |
| **Unfinanced Capital Expenditure** | 0 | 3.855 | 0 |

The significant reduction in the actual capital expenditure compared to the initial estimate is a result of delays in the delivery of a number of significant Estate schemes resulting from a review of the Estate Strategy, along with long lead times for supply from vehicle manufacturers. |
| **3.2** | **Borrowing Requirement** |
| 3.2.13.2.23.2.33.2.4 | The PCC’s underlying need to borrow is called the Capital Financing Requirement (CFR). This figure is a gauge of the PCC’s debt position. It represents 2022/23 and any prior years’ capital expenditure which has not yet been financed by revenue or other resources. Part of the PCC’s treasury activity is to address this borrowing need, either through borrowing from external bodies, or utilising temporary internal cash resources.Under treasury management arrangements, actual debt can be borrowed or repaid at any time within the confines of the annual Treasury Management Strategy. However, the PCC is required to make an annual revenue charge to reduce the CFR. This statutory revenue charge is called the Minimum Revenue Provision (MRP). The total CFR can also be reduced by:1. The application of additional capital resources; or
2. Charging more than the statutory revenue charge (MRP) each year through a Voluntary Revenue Provision (VRP).

The PCC’s CFR for the year is shown below and represents a key prudential indicator.

|  |  |  |  |
| --- | --- | --- | --- |
|   | 2021/22 | 2022/23 | 2022/23 |
|   | Actual | Estimate | Actual |
|   | £m | £m | £m |
| Capital Financing Requirement | 0 | 4.944 | 0 |

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| **3.3** | **Treasury Position** |
| 3.3.13.3.23.3.3 | Whilst the PCC’s gauge of his underlying need to borrow is the CFR, the Chief Finance Officer for the PCC can manage the actual borrowing position by either: 1. Borrowing to the CFR amount;
2. Choosing to utilise some temporary internal cash flow funds in lieu of borrowing (under-borrowing); or
3. Borrowing for potential future increases in the CFR (borrowing in advance of need).

 The figures in this report are based on the carrying amounts borrowed and invested and therefore reflect those figures disclosed in the Statement of Accounts.The treasury position at the 31st March 2023 compared with previous year comparators was:

|  |  |  |
| --- | --- | --- |
|   | 31st March 2022 | 31st March 2023 |
|   |   | Average  |   | Average  |
|   |  | Interest  |   | Interest  |
|   | Principal | Rate | Principal | Rate |
|  | £m | % | £m | % |
| Actual Borrowing Position |  |  |  |  |
| Fixed Rate Debt | 0 | 0 | 0 | 0 |
| Variable Rate Debt | 0 | 0 | 0 | 0 |
| Total Debt | 0 | 0 | 0 | 0 |
| Underlying Borrowing Requirement (excl. PFI) | 0 |  | 0 |  |
| (Over) / Under Borrowing | 0 |  | 0 |  |
|   |  |  |  |  |
| Actual Investment Position |  |  |  |  |
| Fixed Interest Investments | 24.030 | 0.21 | 30.244 | 2.47 |
| Variable Interest Investments | 8.002 | 0.18 | 5.022 | 2.23 |
| Total Investments | 32.032 |  | 35.266 |  |
|   |  |  |  |  |
| Cash & Cash Equivalents | 1.414 |  | 1.539 |  |
|  |  |  |  |  |
| Net Borrowing | (33.446) |  | (36.805) |  |
|   |   |   |  |  |

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| **3.4** | **Prudential Indicators and Compliance Issues** |
| 3.4.13.4.23.4.33.4.43.4.53.4.63.4.73.4.8 | Some of the Prudential Indicators provide either an overview or specific limits on treasury activity and these are shown below:Gross Borrowing and the CFRIn order to ensure that borrowing levels are prudent over the medium term the PCC’s borrowing must only be for a capital purpose. Gross borrowing should not therefore, except in the short term, have exceeded the CFR for 2022/23 plus the expected changes to the CFR over 2023/24 and 2024/25 etc. The table below highlights the PCC’s gross borrowing position against the CFR.

|  |  |  |  |
| --- | --- | --- | --- |
|   | 2021/22 | 2022/23 | 2022/23 |
|   | Actual | Estimate | Actual |
|   | £m | £m | £m |
| Gross Borrowing (incl. PFI) | 0 | 4.944 | 0 |
| External Borrowing (excl. PFI) | 0 | 4.944 | 0 |
| Capital Financing Requirement (CFR) | 0 | 4.944 | 0 |

The above table shows that gross debt is exactly the same as the CFR and therefore this prudential indicator has been met. The Authorised Limit The Authorised Limit is the ‘Affordable Borrowing Limit’ required by Section 3 of the Local Government Act 2003. The PCC does not have the power to borrow above this level.The table below demonstrates that during 2022/23 the PCC maintained gross borrowing within the Authorised Limit. The Operational BoundaryThe Operational Boundary is the expected borrowing position during the year. Periods where the actual position is either below or over the Operational Boundary are acceptable subject to the Authorised Limit not being breached.Maximum Gross Borrowing This is the Gross Borrowing at the beginning of the financial year.Average Gross BorrowingThis is the average of the borrowing position at the beginning of the year and the borrowing position at the end of the year.

|  |  |
| --- | --- |
|   | 2022/23 |
|   | £m |
| Authorised Borrowing Limit | 10.989 |
| Operational Boundary | 5.207 |
| Actual Maximum Gross Borrowing Position | 0 |
| Average Gross Borrowing Position | 0 |
| Estimated Financing Costs as a % of Net Revenue Stream  | 0.06% |
| Actual Financing Costs as a % of Net Revenue Stream | (0.39%) |

Actual financing costs as a proportion of Net Revenue Stream This indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the Net Revenue Stream (NRS). For the calculation, NRS equals the Revenue Budget for the year of £156.247m.Actual Financing costs as a % of NRS is a negative as all external debt was settled in 2016/17 and there was no need to borrow as anticipated in the 2022/23 Treasury Management Strategy; yet investment income has been received thereby providing a surplus of financing costs. |
| **3.5** | **Economic Background and Interest Rates** |
| 3.5.13.5.23.5.33.5.43.5.53.5.63.5.73.5.83.5.93.5.103.5.11 | **UK Economy**Against a backdrop of stubborn inflationary pressures; the easing of Covid 19 restrictions in most developed economies; the Russian invasion of Ukraine; and a range of different UK Government policies, it is no surprise that UK interest rates have been volatile right across the curve, from Bank Rate through to 50-year gilt yields, for all of 2022/23.Market commentators’ misplaced optimism around inflation has been the root cause of the rout in the bond markets with, for example, UK, Eurozone and US 10-year yields all rising by over 200 basis points (bps) in 2022. The table below provides a snapshot of the conundrum facing central banks: inflation is elevated but labour markets are extra-ordinarily tight, making it an issue of fine judgment as to how far monetary policy needs to tighten.

|  |  |  |  |
| --- | --- | --- | --- |
|  | **UK** | **Eurozone** | **US** |
| **Bank Rate** | 4.25% | 3% | 4.75%-5% |
| **Gross Domestic Products (GDP)** | +0.1% q/q Q4 (4.1% y/y) | +0.1% q/q Q4 (1.9% y/y) | +2.6% Q4 Annualised |
| **Inflation** | 10.4% y/y (Feb) | 6.9% y/y (Mar) | 6.0% y/y (Feb) |
| **Unemployment Rate** | 3.7% (Jan) | 6.6% (Feb) | 3.6% (Feb) |

Quarter 2 of 2022 saw UK GDP deliver growth of +0.1% quarter on quarter (q/q), but this was quickly reversed in the third quarter, albeit some of the fall in GDP can be placed at the foot of the extra Bank Holiday in the wake of the Queen’s passing. Q4 GDP was positive at 0.1% q/q. Most recently, January saw a 0.3% month on month increase in GDP as the number of strikes reduced compared to December. In addition, the resilience in activity at the end of 2022 was, in part, due to a 1.3% q/q rise in real household disposable incomes. A big part of that reflected the £5.7bn payments received by households from the Government under the Energy Bills Support Scheme. Nevertheless, Consumer Price Inflation (CPI) picked up to what should be a peak reading of 11.1% in October 2022, although hopes for significant falls from this level will very much rest on the movements in the gas and electricity markets, as well as the supply-side factors impacting food prices. On balance, most commentators expect the CPI measure of inflation to drop back towards 4% by the end of 2023. As of February 2023, CPI was 10.4%.The UK unemployment rate fell through 2022 to a 48-year low of 3.6% and this despite a net migration increase of circa 600k. The fact remains however, that with many economic participants registered as long-term sick, the UK labour force shrunk by circa 500k in the year to June. Without an increase in the labour force participation rate, it is hard to see how the UK economy will be able to grow its way to prosperity and with average wage increases running at over 6%, the Monetary Policy Committee (MPC) will be concerned that wage inflation will prove just as sticky as major supply-side shocks to food (up 18.3% year on year in February 2023) and energy that have endured since Russia’s invasion of Ukraine in February 2022.Bank Rate increased steadily throughout 2022/23, starting at 0.75% and finishing at 4.25%. During this time, following a Conservative Party leadership contest, Liz Truss M.P. became Prime Minister for a tumultuous seven weeks that ran through September and October 2022. Put simply, the markets did not like the unfunded tax-cutting and heavy spending policies put forward by her Chancellor, Kwasi Kwarteng M.P. and their tenure lasted barely seven weeks before being replaced by Prime Minister Rishi Sunak M.P and Chancellor Jeremy Hunt M.P. Their Autumn Statement of the 17th of November 2022 gave rise to a net £55bn of fiscal tightening, although much of the ‘heavy lifting’ has been left for the next Parliament to deliver. However, the markets liked what they heard, and UK gilt yields have reversed the increases seen under Liz Truss’s Premiership, although they remain elevated in line with developed economies generally.As noted above, GDP has been tepid throughout 2022/23, although the most recent composite Purchasing Manager Indices for the UK, US, Eurozone and China have all surprised to the upside, registering survey scores just above 50 (below suggests economies are contracting, and above suggests expansion). Whether that means a shallow recession, or worse, will be avoided is still unclear. Ultimately, the MPC will want to see material evidence of a reduction in inflationary pressures and a loosening in labour markets. Realistically, that is an unlikely outcome without unemployment rising and wage settlements falling from their current levels. At present, the bigger rise in employment kept the International Labour Organisation’s unemployment rate unchanged at 3.7% in January 2023. Also, while the number of job vacancies fell for the ninth consecutive month in February 2023, they remained around 40% above pre-pandemic levels.Capital Economics expect real GDP to contract by around 0.2% q/q in Q1 of 2023 and forecast a recession this year involving a 1.0% peak-to-trough fall in real GDP. The Pound has remained resilient of late, recovering from a record low of $1.035, on the Monday following Liz Truss’s government’s ‘Fiscal Event’, to $1.23. Notwithstanding the Pound’s better run of late, 2023 is likely to see a housing correction of some magnitude as fixed-rate mortgages have moved above 4.5% and affordability has been squeezed despite proposed Stamp Duty cuts remaining in place.As for equity markets, the FTSE 100 started 2023 strongly, rising to a record high of 8,014 on 20th February, as resilient data and falling inflation boosted earnings. But global equities fell sharply after concerns over the health of the global banking system emerged early in March. The fall in the FTSE 100 was bigger than the drop in the US Standard & Poor’s (S&P) 500. Indeed, at around 7,600 now, the FTSE is 5.2% below its record high on 20th February, while the S&P 500 is only 1.9% lower over the same period. That’s despite UK banks having been less exposed and equity prices in the UK’s financial sector not falling as far. It may be due to the smaller decline in UK interest rate expectations and bond yields, which raise the discounted value of future earnings, compared to the US.**USA**The flurry of comments from Federal Reserve officials over recent months suggest there is still an underlying hawkish theme to their outlook for interest rates. Markets are pricing in further interest rate increases of 25-50bps, on top of the current interest rate range of 4.75% - 5%. In addition, the Federal Reserve is expected to continue to run down its balance sheet once the on-going concerns about some elements of niche banking provision are “in the rear-view mirror”. As for inflation, it is currently at circa 6% but with the economy expected to weaken during 2023 and wage data already falling back, there is the prospect that should the economy slide into a recession of any kind there will be scope for rates to be cut at the backend of 2023 or shortly after.**EU**Although the Eurozone inflation rate has fallen below 7%, the European Central Bank will still be mindful that it has further work to do to dampen inflation expectations and it seems destined to raise rates to 4% in order to do so. Like the UK, growth has remained more robust than anticipated but a recession in 2023 is still seen as likely by most commentators. |
| **3.6** | **Investment Position** |
| 3.6.13.6.23.6.33.6.4 | Investment Policy – The PCC’s investment policy is governed by the Welsh Government, which has been implemented in the annual investment strategy. Resources – The PCC’s longer term cash balances comprise primarily of revenue and capital resources, although these will be influenced by cash flow considerations. The PCC’s core cash resources were comprised as follows and these represent the majority of funds available for investment:

|  |  |  |
| --- | --- | --- |
|  | 2021/22 | 2022/23 |
|   | £m | £m |
| General Reserves | 5.000 | 5.000 |
| Earmarked Reserves | 28.270 | 24.473 |
| Provisions | 1.720 | 2.206 |
| Useable Capital Receipts | 0.301 | 0.301 |
| Total  | 35.291 | 31.980 |

Investments Held by the PCC - The PCC concluded the year with a balance of £35.266m of internally managed funds which compares with a budget assumption of £29.359m as per the annual Treasury Management Strategy. The difference between the budget and actual position is explained by slippage of capital programme schemes in 2022/23 and beyond and in-year savings against budget which has resulted in surplus funds available for investment purposes.These internally managed funds received a weighted average return of 0.85% compared to a budget assumption of 0.28%. The comparable performance indicator is the annual average SONIA rate, which was 2.26%. The annual performance is lower as the PCC was tied into the fixed interest rates which were agreed when the rates were at a low. The rates of the more recent investments are above the SONIA average ranging from 4.15% to 4.40% and Members should note the simple average rate received on fixed-term investments of 2.47% during 2022/23, as per paragraph 3.3.3. above. |
| **3.7** | **Regulatory Framework, Risk and Performance** |
| 3.7.13.7.2 | The PCC’s treasury management activities are regulated by a variety of professional codes, statutes and guidance:1. CIPFA’s Treasury Management Code of Practice (2022 Edition);
2. CIPFA Guide for Chief Financial Officers on Treasury Management in Local Authorities;
3. CIPFA Standard of Professional Practice on Treasury Management;
4. The Prudential Code for Capital Finance in Local Authorities (2021 Edition);
5. Local Government Act 2003;
6. Bank of England Non Investment Products Code (2011);
7. Standing Orders relating to Contracts;
8. Financial Standing Orders, Regulations and Procedures;
9. The Commissioner’s Manual of Corporate Governance and Scheme of Delegation; and
10. Markets in Financial Instruments Directive (MiFiD II).

The PCC complied with all of the above relevant statutory and regulatory requirements which require the PCC to identify and, where possible, quantify the levels of risk associated with his treasury management activities. In particular his adoption and implementation of both the Prudential Code and the Code of Practice for Treasury Management means both that his capital expenditure is prudent, affordable and sustainable, and his treasury practices demonstrate a low risk approach. |
| **4.** | **NEXT STEPS** |
| 4.1 | A Treasury Management update report, reviewing performance for the first six months of 2023/24 will be presented to the Joint Audit Committee in December 2023. |
| **5.** | **FINANCIAL CONSIDERATIONS** |
| 5.1 | These are detailed in the report. |
| **6.** | **PERSONNEL CONSIDERATIONS** |
| 6.1 | There are no staffing/personnel implications arising from this report. |
| **7.** | **LEGAL IMPLICATIONS** |
| 7.1 | There are no legal implications arising from this report. |
| **8.** | **EQUALITIES AND HUMAN RIGHTS CONSIDERATIONS** |
| 8.1 | This proposal has been considered against the general duty to promote equality, as stipulated under the Strategic Equality Plan and has been assessed not to discriminate against any particular group.  |
| 8.2 | In preparing this report, consideration has been given to the requirements of the Articles contained in the European Convention on Human Rights and the Human Rights Act 1998. |
| **9.** | **RISK** |
| 9.1 | Treasury management can never be risk free. In borrowing, the risk is that the PCC incurs a higher interest charge than was necessary and in lending there is the risk of default on repayment and the risk that a better rate of interest could have been achieved from an alternative borrower with acceptable credit status. Adherence to the CIPFA Code of Practice on Treasury Management is best practice in terms of balancing risk and return. |
| **10.** | **PUBLIC INTEREST** |
| 10.1 | This is a public document. |
| **11.** | **CONTACT OFFICER** |
| 11.1 | Darren Garwood-Pask, Chief Finance Officer. |
| **12.** | **ANNEXES** |
| 12.1 | None. |