

Decision log: PCCG-2024-014

OFFICE OF THE POLICE & CRIME COMMISSIONER

OFFICE OF THE CHIEF CONSTABLE

TITLE:	Treasury Management Annual Report 2023/24
DATE:	9th September 2024
TIMING:	Routine
PURPOSE:	For consideration
1.	<u>RECOMMENDATION</u>
1.1	That the Annual Treasury Management Activity Report and actual Prudential Indicators for 2023/24 are approved.
2.	<u>INTRODUCTION & BACKGROUND</u>
2.1	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.
2.2	The Treasury Management Annual Report is a requirement of the Police and Crime Commissioner's (PCC's) statutory reporting responsibilities.
2.3	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.
2.4	The report covers both Treasury Management activity during 2023/24 and the actual Prudential Indicators for 2023/24.
2.5	During 2023/24 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.	<u>ISSUES FOR CONSIDERATION</u>
3.1	<u>Capital Expenditure and Financing</u>
3.1.1	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: a) 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 b) If insufficient financing is available, or a decision is taken not to apply resources, the capital expenditure will give rise to a borrowing need.

3.1.2

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 2023/24 Estimate of Capital expenditure is as per the Treasury Management Strategy for 2023/24.

	2022/23 Actual £m	2023/24 Estimate £m	2023/24 Actual £m
Capital Expenditure	7.463	23.902	10.132
Financed by:			
Capital Receipts	0	0.000	0.301
Capital Grants and PIF Grants	0	0.014	0.000
Reserves	0.994	6.662	3.586
Revenue	6.469	6.226	6.245
Unfinanced Capital Expenditure	0	11.000	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, including the Joint Firearms Unit Range build.

3.2 Borrowing Requirement

3.2.1 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 2023/24 and any prior years' capital expenditure which has not yet been financed by revenue or other resources.

3.2.2 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.

3.2.3 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:

- a) The application of additional capital resources; or
- b) Charging more than the statutory revenue charge (MRP) each year through a Voluntary Revenue Provision (VRP).

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

	2022/23 Actual £m	2023/24 Estimate £m	2023/24 Actual £m
Capital Financing Requirement	0	10.560	0

3.3 Treasury Position

3.3.1 Whilst the PCC's gauge of their underlying need to borrow is the CFR, the Chief Finance Officer for the PCC can manage the actual borrowing position by either:

- a) Borrowing to the CFR amount;
- b) Choosing to utilise some temporary internal cash flow funds in lieu of borrowing (under-borrowing); or
- c) Borrowing for potential future increases in the CFR (borrowing in advance of need).

3.3.2 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.

3.3.3 The treasury position at the 31st March 2024 compared with previous year comparators was:

	31 st March 2023		31 st March 2024	
	Principal £m	Average Interest Rate %	Principal £m	Average Interest Rate %
<u>Actual Borrowing Position</u>				
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	
<u>Actual Investment Position</u>				
Fixed Interest Investments	30.244	2.47	14.333	5.50
Variable Interest Investments	5.022	2.23	10.132	5.01
Total Investments	35.266		24.465	
Cash & Cash Equivalents	1.539		1.893	
Net Borrowing	(36.805)		(26.358)	

3.4 Prudential Indicators and Compliance Issues

3.4.1 Some of the Prudential Indicators provide either an overview or specific limits on treasury activity and these are shown below:

3.4.2 Gross Borrowing and the CFR
 In 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 2023/24 plus the expected

changes to the CFR over 2024/25 and 2025/26 etc. The table below highlights the PCC's gross borrowing position against the CFR.

	2022/23 Actual £m	2023/24 Estimate £m	2023/24 Actual £m
Gross Borrowing (incl. PFI)	0	10.560	0
External Borrowing (excl. PFI)	0	10.560	0
Capital Financing Requirement (CFR)	0	10.560	0

The above table shows that gross debt is exactly the same as the CFR and therefore this prudential indicator has been met.

3.4.3

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 2023/24 the PCC maintained gross borrowing within the Authorised Limit.

3.4.4

The Operational Boundary

The 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.

3.4.5

Maximum Gross Borrowing

This is the Gross Borrowing at the beginning of the financial year.

3.4.6

Average Gross Borrowing

This is the average of the borrowing position at the beginning of the year and the borrowing position at the end of the year.

	2023/24 £m
Authorised Borrowing Limit	12.229
Operational Boundary	11.000
Actual Maximum Gross Borrowing Position	0
Average Gross Borrowing Position	0
Estimated Financing Costs as a % of Net Revenue Stream	0.43%
Actual Financing Costs as a % of Net Revenue Stream	(1.23%)

3.4.7

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 £161.587m.

3.4.8

Actual Financing costs as a % of NRS is a negative as all external debt was settled in 2016/17. The actual percentage is a negative compared to the estimated value as there was no need to borrow as anticipated in the 2023/24 Treasury Management Strategy.

3.5 Economic Background and Interest Rates

UK Economy

3.5.1 Against a backdrop of stubborn inflationary pressures, the Russian invasion of Ukraine, and war in the Middle East, UK interest rates have continued to be volatile right across the curve, from Bank Rate through to 50-year gilt yields, for all of 2023/24. Markets have sought an end to central banks' on-going phase of keeping restrictive monetary policy in place on at least one occasion during 2023/24, but to date only the Swiss National Bank has cut rates and that was at the end of March 2024.

UK, Eurozone (EZ) and US 10-year yields have all stayed stubbornly high throughout 2023/24. The table below provides a snapshot of the conundrum facing central banks: inflation is easing, albeit gradually, but labour markets remain very tight by historical comparisons, making it an issue of fine judgment as to when rates can be cut.

	UK	Eurozone	US
Bank Rate	5.25%	4%	5.25%-5.5%
GDP	-0.3%q/q Q4 (-0.2%y/y)	+0.0%q/q Q4 (0.1%y/y)	2.0% Q1 Annualised
Inflation	3.4%y/y (Feb)	2.4%y/y (Mar)	3.2%y/y (Feb)
Unemployment Rate	3.9% (Jan)	6.4% (Feb)	3.9% (Feb)

3.5.2 The Bank of England sprung no surprises in their March meeting, leaving interest rates at 5.25% for the fifth time in a row and, despite no Monetary Policy Committee (MPC) members no longer voting to raise interest rates, it retained its relatively hawkish guidance. The Bank's communications suggest the MPC is gaining confidence that inflation will fall sustainably back to the 2.0% target. However, although the MPC noted that "the restrictive stance of monetary policy is weighing on activity in the real economy; is leading to a looser labour market; and is bearing down on inflationary pressures", conversely it noted that key indicators of inflation persistence remain elevated and policy will be "restrictive for sufficiently long" and "restrictive for an extended period".

3.5.3 The UK economy has started to perform a little better in Q1 2024, but is still recovering from a shallow recession through the second half of 2023. Indeed, Q4 2023 saw negative GDP growth of (0.3)% while y/y growth was also negative at (0.2)%. But it was a strange recession. Unemployment is currently sub 4%, against a backdrop of still over 900k of job vacancies, and annual wage inflation is running at above 5%. With gas and electricity price caps falling in April 2024, the CPI measure of inflation, which peaked at 11.1% in October 2022, is now due to slide below the 2% target rate in April and to remain below that Bank of England benchmark for the next couple of years, according to Capital Economics. The Bank of England still needs some convincing, but upcoming inflation and employment releases will settle that argument shortly. It is noted that core CPI was still a heady 4.5% in February and, ideally, needs to fall further.

3.5.4	<p>Shoppers largely shrugged off the unusually wet weather in February, whilst rising real household incomes should support retail activity throughout 2024. Furthermore, the impact of higher interest rates on household interest payments is getting close to its peak, even though fixed rate mortgage rates on new loans have shifted up a little since falling close to 4.5% in early 2024.</p>
3.5.5	<p>From a fiscal perspective, the further cuts to National Insurance tax (from April) announced in the March Budget will boost real household disposable income by 0.5 - 1.0%. After real household disposable income rose by 1.9% in 2023, Capital Economics forecast it will rise by 1.7% in 2024 and by 2.4% in 2025. These rises in real household disposable income, combined with the earlier fading of the drag from previous rises in interest rates, means GDP growth of 0.5% is envisaged in 2024 and 1.5% in 2025. The Bank of England is less optimistic than that, seeing growth struggling to get near 1% over the next two to three years.</p>
3.5.6	<p>As for equity markets, the FTSE 100 has risen to nearly 8,000 and is now only 1% below the all-time high it reached in February 2023. The modest rise in UK equities in February was driven by strong performances in the cyclical industrials and consumer discretionary sectors, whilst communications and basic materials have fared poorly. Despite its performance, the FTSE 100 is still lagging behind the S&P 500, which has been at an all-time high for several weeks.</p>
	<p>USA</p>
3.5.6	<p>Despite the markets willing the Federal Open Market Committee (FOMC) to cut rates as soon as June 2024, the continued resilience of the economy, married to sticky inflation, is providing a significant headwind to a change in monetary policy. Markets currently anticipate three rate cuts this calendar year, but two or less would not be out of the question. Currently, policy remains flexible but primarily data driven.</p>
3.5.7	<p>In addition, the Fed will want to shrink its swollen \$16 trillion balance sheet at some point. Just because the \$ is the world's foremost reserve currency (China owns over \$1 trillion) does not mean the US can continually run a budget deficit. The mix of stubborn inflation and significant treasury issuance is keeping treasury yields high. The 10 year stands at 4.4%.</p>
3.5.8	<p>As for inflation, it is currently a little above 3%. The market is not expecting a recession, but whether rates staying high for longer is conducive to a soft landing for the economy is uncertain, hence why the consensus is for rate cuts this year and into 2025 but how many and when remains unknown.</p>
3.5.9	<p>EU</p> <p>Although the Euro-zone inflation rate has fallen to 2.4%, the European Central Bank (ECB) will still be mindful that it has further work to do to dampen inflation expectations. However, with growth steadfastly in the slow lane (GDP flatlined in 2023), a June rate cut from the current 4% looks probable.</p>
3.6	Investment Position
3.6.1	<p>Investment Policy – The PCC's investment policy is governed by the Welsh Government, which has been implemented in the annual investment strategy.</p>

3.6.2 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 total funds available for investment:

	2022/23 £m	2023/24 £m
General Reserves	5.000	5.500
Earmarked Reserves	24.473	15.624
Provisions	2.206	1.482
Useable Capital Receipts	0.301	0.023
Total	31.980	22.629

3.6.3 Investments Held by the PCC - The PCC concluded the year with a balance of £24.465m of internally managed funds which compares with a budget assumption of £14.277m as per the annual Treasury Management Strategy. The difference between the budget and actual position is explained by slippage of capital programme schemes in 2023/24 and beyond and in year savings against budget which has resulted in surplus funds available for investment purposes.

3.6.4 These internally managed funds received a weighted average return of 4.19% compared to a budget assumption of 2.86%. The comparable performance indicator is the annual average SONIA rate, which was 4.96%. The annual performance is lower as PCC was tied into the fixed interest rates which were agreed when the rates were lower. The rates of the investments towards the year end were above the SONIA average ranging from 5.50% to 5.55%.


3.7 Regulatory Framework, Risk and Performance

3.7.1 The PCC’s treasury management activities are regulated by a variety of professional codes, statutes and guidance:

- a) CIPFA’s Treasury Management Code of Practice (2021 Edition);
- b) CIPFA Guide for Chief Financial Officers on Treasury Management in Local Authorities;
- c) CIPFA Standard of Professional Practice on Treasury Management;
- d) The Prudential Code for Capital Finance in Local Authorities (2021 Edition);
- e) Local Government Act 2003;
- f) Bank of England Non Investment Products Code (2011);
- g) Standing Orders relating to Contracts;
- h) Financial Standing Orders, Regulations and Procedures;
- i) The Commissioner’s Manual of Corporate Governance and Scheme of Delegation; and
- j) Markets in Financial Instruments Directive (MiFiD II).

3.7.2 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 their treasury management activities. In particular their adoption and implementation of both the Prudential Code and the Code of Practice for Treasury Management means both that their capital expenditure is prudent, affordable and sustainable, and their treasury practices demonstrate a low risk approach.

4.	<u>NEXT STEPS</u>
4.1	A Treasury Management update report, reviewing performance for the first six months of 2024/25 will be presented to the Joint Audit Committee in December 2024.
5.	<u>FINANCIAL CONSIDERATIONS</u>
5.1	These are detailed in the report.
6.	<u>PERSONNEL CONSIDERATIONS</u>
6.1	There are no staffing/personnel implications arising from this report.
7.	<u>LEGAL IMPLICATIONS</u>
7.1	There are no legal implications arising from this report.
8.	<u>EQUALITIES AND HUMAN RIGHTS CONSIDERATIONS</u>
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.	<u>RISK</u>
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.	<u>PUBLIC INTEREST</u>
10.1	This is a public document.
11.	<u>CONTACT OFFICER</u>
11.1	Darren Garwood-Pask, Chief Finance Officer.
12.	<u>ANNEXES</u>
12.1	None.

Mrs Jane Mudd, Police and Crime Commissioner for Gwent	
My decision is as I have recorded in this paper	
Signed 	Date 4.12.2024