OFFICE OF THE POLICE & CRIME COMMISSIONER

OFFICE OF THE CHIEF CONSTABLE

TITLE:	**Treasury Management Annual Report 2016/17**
DATE:	**29th June 2017**
TIMING:	**Routine**
PURPOSE:	**For consideration**

1.	**RECOMMENDATION**
1.1	That the Annual Treasury Management Activity Report and actual Prudential Indicators for 2016/17 are approved.
2.	**INTRODUCTION & BACKGROUND**
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 2016/17 and the actual Prudential Indicators for 2016/17.
2.5	During 2016/17 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**
3.1.1	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 2016/17 Estimate of Capital expenditure is as per the Treasury Management Strategy for 2016/17.

	2015/16 Actual £m	2016/17 Estimate £m	2016/17 Actual £m
Total Capital Expenditure	2.492	4.209	1.817
Financed by:			
Capital Receipts	0.000	0.000	0.000
Capital Grants	1.181	0.876	0.529
Reserves	1.311	3.333	0.692
Revenue	0.000	0.000	0.596
Supported Borrowing	0.000	0.000	0.000
Increase/(decrease) in Capital Creditors	0.000	0.000	0.000
Total Financing	2.492	4.209	1.817
Unfinanced Capital Expenditure	0.000	0.000	0.000

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 2016/17 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.

	2015/16 Actual £m	2016/17 Estimate £m	2016/17 Actual £m
Capital Financing Requirement	6.200	6.573	4.752

During 2016/17, the PCC's Public Works Loan Board (PWLB) and Newport

3.2.5 City Council's (NCC) debt was repaid in full, following an assessment of Value for Money and based on grounds of affordability. The exit price for the PWLB loans including the penalty charge comprised £4.260m principal, £0.034m accrued interest and a premium of £1.435m, totalling £5.729m. For the NCC loans the amounts were £0.565m principal and interest penalty of £0.084m.

3.2.6 The associated accounting entries of the above repayment of debt necessitated a VRP to be made (funded through revenue) of £1.356m. This was in addition to the statutory MRP of £0.056m. The overall effect of these cash and accounting transactions, coupled with the fact that no new loans were taken up in respect of approved capital expenditure during the year, means that there was £0.0m (zero) loan debt outstanding as at 31st March 2017. Therefore, the Commissioner has no further liability to make future MRPs.

3.2.7 The remaining CFR of £4.752m identified above, equates solely to the finance lease liability within the PFI contract for Ystrad Mynach; this will be reduced to zero through the life of the contract. However, a tender has been drafted for the financial advice to progress the evaluation and conclusion of the PFI provision. An initial evaluation has determined that it is value for money to undertake a voluntary termination of the contract and the financial adviser will manage the process to termination during the 2017/18 financial year.

3.3 Treasury Position

3.3.1 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:

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 discloses in the Statement of Accounts.

3.3.3 The treasury position at the 31st March 2017 compared with previous year comparators was:

	31st March 2016		31st March 2017	
	Principal £m	Average Interest Rate %	Principal £m	Average Interest Rate %
Actual Borrowing Position				
Fixed Rate Debt	4.294	5.8	0	5.8
Variable Rate Debt	0.646	6.6	0	6.6
Total Debt	4.940	6.0	0	6.0

Underlying Borrowing Requirement (excl. PFI)	1.412		0	
(Over) / Under Borrowing	(3.528)		0	
Actual Investment Position				
Fixed Interest Investments	37.040	0.35	36.032	0.35
Variable Interest Investments	9.006	0.44	10.002	0.34
Total Investments	46.046		46.034	
Cash & Cash Equivalents	15.141		13.070	
Net Borrowing	(56.247)		(59.104)	

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 2016/17 plus the expected changes to the CFR over 2017/18 and 2018/19 etc. The table below highlights the PCC's gross borrowing position against the CFR.

	2015/16 Actual £m	2016/17 Estimate £m	2016/17 Actual £m
Gross Borrowing (incl. PFI)	9.728	9.498	4.752
External Borrowing (excl. PFI)	4.940	4.746	0
Capital Financing Requirement (CFR)	6.200	6.573	4.752

3.4.3 The above table shows that gross debt is exactly the same as the CFR and therefore this prudential indicator has been met and reflects the Commissioner's decision to repay all external borrowing during 2016/17.

3.4.4 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 2016/17 the PCC maintained gross borrowing within the Authorised Limit.

3.4.5 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.

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

3.4.7 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.

	2016/17 £m
Authorised Borrowing Limit	12.498
Operational Boundary	9.498
Actual Maximum Gross Borrowing Position	9.728
Average Gross Borrowing Position	7.240
Estimated Financing Costs as a % of Net Revenue Stream	0.19%
Actual Financing Costs as a % of Net Revenue Stream	1.33%

3.4.8 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 £119.539m.

Actual Financing costs as a % of NRS increased by 1.14% as a result of the premium and interest penalties incurred as a result of paying off external debt, offset by a reduced MRP (£0.020m) and more investment income received during the year than forecasted (£0.112m).

3.5 Economic Background and Interest Rates

3.5.1 The two major landmark events that had a significant influence on financial markets in the 2016/17 financial year were the UK EU referendum on 23rd June 2016 and the election of President Trump in the USA on 9th November 2016. The first event had an immediate impact in terms of market expectations of when the first increase in Bank Rate would happen, pushing it back from quarter 3 2018 to quarter 4 2019. At its 4th August 2016 meeting, the Monetary Policy Committee (MPC) cut Bank Rate from 0.5% to 0.25% and the Bank of England's Inflation Report produced forecasts warning of a major shock to economic activity in the UK, which would cause economic growth to fall almost to zero in the second half of 2016. The MPC also warned that it would be considering cutting Bank Rate again towards the end of 2016 in order to support growth. In addition, it restarted quantitative easing with purchases of £60bn of gilts and £10bn of corporate bonds, and also introduced the Term Funding Scheme whereby potentially £100bn of cheap financing was made available to banks.

3.5.2 In the second half of 2016, the UK economy confounded the Bank's pessimistic forecasts of August. After a disappointing quarter 1 of only +0.2% GDP growth, the three subsequent quarters of 2016 came in at

	+0.6%, +0.5% and +0.7% to produce an annual growth for 2016 overall, compared to 2015, of no less than 1.8%, which was very nearly the fastest rate of growth of any of the G7 countries. Needless to say, this meant that the MPC did not cut Bank Rate again after August but, since then, inflation has risen rapidly due to the effects of the sharp devaluation of sterling after the referendum. By the end of March 2017, sterling was 17% down against the dollar but had not fallen as far against the euro. In February 2017, the latest Consumer Price Index (CPI) inflation figure had risen to 2.3%, above the MPC's inflation target of 2%. However, the MPC's view was that it would look through near term supply side driven inflation, (i.e. not raise Bank Rate), caused by sterling's devaluation, despite forecasting that inflation would reach nearly 3% during 2017 and 2018. This outlook, however, is dependent on domestically generated inflation, (i.e. wage inflation), continuing to remain subdued despite the fact that unemployment is at historically very low levels and is on a downward trend. Market expectations for the first increase in Bank Rate moved forward to quarter 3 2018 by the end of March 2017 in response to increasing concerns around inflation.
3.6	**Investment Position**
3.6.1	Investment Policy – The PCC's investment policy is governed by the Welsh Government, which has been implemented in the annual investment strategy. The investment activity during the year conformed to the approved strategy, and the PCC had no liquidity difficulties.
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:

	2015/16 £m	2016/17 £m
General Reserves	9.112	10.905
Earmarked Reserves	38.851	39.701
Provisions	1.088	1.355
Useable Capital Receipts	1.626	2.204
Total	50.677	54.165

3.6.3	Investments Held by the PCC - The PCC concluded the year with a balance of £54.165m of internally managed funds which compares with a budget assumption of £31.185m as per the annual Treasury Management Strategy. The difference between the budget and actual position is explained by slippage of capital programme schemes into 2017/18 and beyond (particularly in relation to the replacement of HQ)) and in year savings against budget which has resulted in surplus funds available for investment purposes.
3.6.4	These internally managed funds received an average return of 0.35% compared to a budget assumption of 0.39%. The comparable performance indicator is the average 7-day LIBID rate, which was 0.20%. The budget

	assumption of 0.39% average, return reflected no decrease in the bank base and a different mix of investments between fixed and variable deposits.
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) The Local Government Act 2003, which provides the powers to borrow and invest as well as providing controls and limits on this activity; b) The Act permits the Welsh Government to set limits either on the PCC or nationally on all local authorities restricting the amount of borrowing which may be undertaken; c) Statutory Instrument (SI) 33239 (W319) 2003, as amended, develops the controls and powers within the Act; d) The SI requires the PCC to undertake any borrowing activity with regard to the CIPFA Prudential Code for Capital Finance in Local Authorities; e) The SI also requires the PCC to operate the overall treasury function with regard to the CIPFA Code of Practice for Treasury Management in the Public Services; f) Under the Act the Welsh Government has issued Investment Guidance to structure and regulate the PCC's investment activities; and g) Under section 238(2) of the Local Government and Public Involvement in Health Act 2007 the Welsh Government has taken powers to issue guidance on accounting practices. Guidance on Minimum Revenue Provision was issued under this section.
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 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.	**<u>NEXT STEPS</u>**
4.1	A Treasury Management update report, reviewing performance for the first six months of 2017/18 will be presented to the Joint Audit Committee in December 2017.
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.	**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.