OFFICE OF THE POLICE & CRIME COMMISSIONER

OFFICE OF THE CHIEF CONSTABLE

TITLE:	**Treasury Management Annual Report 2017/18**
DATE:	**7th June 2018**
TIMING:	**Routine**
PURPOSE:	**For consideration**

1.	**RECOMMENDATION**
1.1	That the Annual Treasury Management Activity Report and actual Prudential Indicators for 2017/18 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 2017/18 and the actual Prudential Indicators for 2017/18.
2.5	During 2017/18 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 2017/18 Estimate of Capital expenditure is as per the Treasury Management Strategy for 2017/18.

	2016/17 Actual £m	2017/18 Estimate £m	2017/18 Actual £m
Total Capital Expenditure	1.817	7.162	1.588
Financed by:			
Capital Receipts	0.000	0.000	0.000
Capital Grants	0.529	0.526	0.449
Reserves	0.692	6.138	0.564
Revenue	0.596	0.498	0.575
Supported Borrowing	0.000	0.000	0.000
Increase/(decrease) in Capital Creditors	0.000	0.000	0.000
Total Financing	1.817	7.162	1.588
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 2017/18 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.

	2016/17	2017/18	2017/18

	Actual £m	Estimate £m	Actual £m
Capital Financing Requirement	4.752	4.686	4.686

3.2.5 During 2017/18 the CFR comprised of £4.686m and 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 2018/19 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 disclosed in the Statement of Accounts.

3.3.3 The treasury position at the 31st March 2018 compared with previous year comparators was:

	31st March 2017		31st March 2018	
	Principal £m	Average Interest Rate %	Principal £m	Average Interest Rate %
Actual Borrowing Position				
Fixed Rate Debt	0	5.8	0	0
Variable Rate Debt	0	6.6	0	0
Total Debt	0	6.0	0	0
Underlying Borrowing Requirement (excl. PFI)	0		0	
(Over) / Under Borrowing	0		0	
Actual Investment Position				
Fixed Interest Investments	36.032	0.35	44.068	0.47
Variable Interest Investments	10.002	0.34	7.003	0.44
Total Investments	46.034		51.071	

Cash & Cash Equivalents	13.070		12.246	
Net Borrowing	(59.104)		(63.317)	

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 2017/18 plus the expected changes to the CFR over 2018/19 and 2019/20 etc. The table below highlights the PCC's gross borrowing position against the CFR.

	2016/17 Actual £m	2017/18 Estimate £m	2017/18 Actual £m
Gross Borrowing (incl. PFI)	4.752	4.686	4.686
External Borrowing (excl. PFI)	0	0	0
Capital Financing Requirement (CFR)	4.752	4.686	4.686

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 2017/18 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.

	2017/18 £m
Authorised Borrowing Limit	11.523
Operational Boundary	4.750
Actual Maximum Gross Borrowing Position	4.686
Average Gross Borrowing Position	4.719
Estimated Financing Costs as a % of Net Revenue Stream	(0.16%)
Actual Financing Costs as a % of Net Revenue Stream	(0.19%)

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 £120.942m.

Actual Financing costs as a % of NRS is a negative as all external debt was settled in 2016/17. The actual percentage is slightly higher than the estimated value due to slippage of capital programme schemes into 2018/19 and beyond. In addition actual interest rate received on investments was higher than forecast.

3.5 Economic Background and Interest Rates

3.5.1 During the calendar year of 2017, there was a major shift in expectations in financial markets in terms of how soon Bank of England Base Rate would start on a rising trend. After the UK economy surprised on the upside with strong growth in the second half of 2016, growth in 2017 was disappointingly weak in the first half of the year which meant that growth was the slowest for the first half of any year since 2012. The main reason for this was the sharp increase in inflation caused by the devaluation of sterling after the EU referendum, feeding increases into the cost of imports into the economy. This caused a reduction in consumer disposable income and spending power as inflation exceeded average wage increases. Consequently, the services sector of the economy, accounting for around 75% of GDP, saw weak growth as consumers responded by cutting back on their expenditure.

3.5.2 However, growth did pick up modestly in the second half of 2017. Consequently, market expectations during the autumn, rose significantly that the Monetary Police Committee (MPC) would be heading in the direction of imminently raising Bank of England Base Rate. The minutes of the MPC meeting of 14th September 2017 indicated that the MPC was likely to raise Bank Rate very soon. The 2nd November 2017 MPC quarterly Inflation Report meeting duly delivered by raising Bank Rate from 0.25% to 0.50%.

3.5.3 The 8th February 2018 Monetary PC 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.

3.5.4 Market expectations for increases in Bank of England Base Rate, therefore, shifted considerably during the second half of 2017/18 and resulted in investment rates from 3 – 12 months increasing sharply during the spring quarter.

3.5.6 Public Works Loan Body (PWLB) borrowing rates increased correspondingly to the above developments with the shorter term rates increasing more sharply than longer term rates. In addition, UK gilts have moved in a relatively narrow band this year, (within 25 base percentage points for much of the year), compared to US treasuries. During the second half of the year, there was a noticeable trend in treasury yields being on a rising trend with the Federal Reserve raising rates by 0.25% in June, December and March, making six increases in all from the floor. The effect of these three increases was greater in shorter terms around 5 year, rather than longer term yields.

3.5.7 The major UK landmark event of the year was the inconclusive result of the general election on 8th June 2017. However, this had relatively little impact on financial markets.

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:

	2016/17 £m	2017/18 £m
General Reserves	10.905	4.000
Earmarked Reserves	39.701	52.131
Provisions	1.355	1.142
Useable Capital Receipts	2.204	1.735
Total	54.165	59.278

3.6.3 Investments Held by the PCC - The PCC concluded the year with a balance of £51.071m of internally managed funds which compares with a budget assumption of £47.788m as per the annual Treasury Management Strategy. The difference between the budget and actual position is explained by slippage of capital programme schemes into 2018/19 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 0.46% compared to a budget assumption of 0.39%. The comparable performance indicator is the average 7-day LIBID rate, which was 0.21%. The budget assumption of 0.39% average return reflected no increase 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 3.7.2	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 (2011 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 (2011 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; and i) The Commissioner's Manual of Corporate Governance and Scheme of Delegation. j) 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.	**<u>NEXT STEPS</u>**
4.1	A Treasury Management update report, reviewing performance for the first six months of 2018/19 will be presented to the Joint Audit Committee in December 2018.
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.	**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.