DECISION NO: PCCG-2016-055		
OFFICE OF THE POLICE & CRIME COMMISSIONER **OFFICE OF THE CHIEF CONSTABLE**		
TITLE:	**Treasury Management Annual Report 2015/16**	
DATE:	30th June 2016	
TIMING:	Routine	
PURPOSE:	For monitoring	

1.	**RECOMMENDATION**
1.1	That the Annual Treasury Management Activity Report and actual Prudential Indicators for 2015/16 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 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 2015/16 and the actual Prudential Indicators for 2015/16.
2.5	During 2015/16 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 2015/16 Estimate of Capital expenditure is as per the Treasury Management Strategy for 2015/16.

	2014/15 Actual £m	2015/16 Estimate £m	2015/16 Actual £m
Total Capital Expenditure	3.058	6.110	2.492
Financed by			
Capital Receipts	0.000	0.000	0.000
Capital Grants	1.875	1.100	1.181
Reserves	1.064	5.010	1.311
Revenue	0.000	0.000	0.000
Supported Borrowing	0.000	0.000	0.000
Increase/(decrease) in Capital Creditors	0.119	0.000	0.000
Total Financing	3.058	6.110	2.492
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 2015/16 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.

	2014/15 Actual £m	2015/16 Estimate £m	2015/16 Actual £m
Capital Financing Requirement	8.125	8.217	6.200

3.2.5	During the year a VRP was made, reducing an earmarked reserve by £1.187m set aside for the repayment of debt. The effect of reducing this reserve also reduced the PCC's CFR requirement for the year and has contributed to a reduced MRP requirement for 2016/17 and onwards.
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 2016 compared with previous year comparators was:

	31st March 2015		31st March 2016	
	Principal £m	Average Interest Rate %	Principal £m	Average Interest Rate %
Actual Borrowing Position				
Fixed Rate Debt	4.294	5.8	4.294	5.8
Variable Rate Debt	0.808	6.5	0.646	6.6
Total Debt	5.102	5.9	4.940	6.0
Underlying Borrowing Requirement (excl. PFI)	3.215		1.412	
(Over) / Under Borrowing	(1.887)		(3.528)	
Actual Investment Position				
Fixed Interest Investments	40.523	0.35	37.040	0.35
Variable Interest Investments	0.000	0.00	9.006	0.44
Total Investments	40.523		46.046	
Cash & Cash Equivalents	11.044		15.141	
Net Borrowing	(46.466)		(56.247)	

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 2015/16 plus the expected changes to the CFR over 2016/17 and 2017/18 etc. The table below highlights the PCC's gross borrowing position against the CFR.

	2014/15 Actual £m	2015/16 Estimate £m	2015/16 Actual £m
Gross Borrowing (incl. PFI)	10.012	9.697	9.728
External Borrowing (excl. PFI)	5.102	4.909	4.940
Capital Financing Requirement (CFR)	8.125	8.217	6.200

3.4.3 The above table shows that gross debt is above CFR and therefore the PCC has not complied with this prudential indicator. In previous years this prudential indicator was calculated by deducting investments from gross debt and comparing this figure with the CFR. The new requirement to exclude investments shows that gross debt needs to be reduced below the CFR. In addition, the CFR has been significantly reduced through the application of a VRP in-year. Resources are available to repay debt however, but such action would incur penalties for early repayment of debt, and it would be expensive and inefficient to do so.

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 2015/16 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 if the average of the borrowing position at the beginning of the year and the borrowing position at the end of the year.

	2015/16 £m
Authorised Borrowing Limit	12.980
Operational Boundary	9.980
Actual Maximum Gross Borrowing Position	9.728

	Average Gross Borrowing Position	9.870
	Estimated Financing Costs as a % of Net Revenue Stream Actual Financing Costs as a % of Net Revenue Stream	0.25% 0.18%
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 £117.774m. Actual Financing costs as a % of NRS decreased by 0.07% as a result of a reduced MRP (£0.004m) plus more investment income received during the year than forecasted (£0.078m).	
3.5	**Economic Background and Interest Rates**	
3.5.1	Market expectations for the first increase in Bank Rate moved considerably during 2015/16, starting at quarter 3 2015 but soon moving back to quarter 1 2016. However, by the end of the year, market expectations had moved back radically to quarter 2 2018 due to many fears including concerns that China's economic growth could be heading towards a hard landing; the potential destabilisation of some emerging market countries particularly exposed to the Chinese economic slowdown; and the continuation of the collapse in oil prices during 2015 together with continuing Eurozone growth uncertainties.	
3.5.2	These concerns have caused sharp market volatility in equity prices during the year with corresponding impacts on bond prices and bond yields due to safe haven flows. Bank Rate, therefore, remained unchanged at 0.5% for the seventh successive year. Economic growth (GDP) in 2015/16 has been disappointing with growth falling steadily from an annual rate of 2.9% in quarter 1 2015 to 2.1% in quarter 4.	
3.5.3	The sharp volatility in equity markets during the year was reflected in sharp volatility in bond yields. However, the overall dominant trend in bond yields since July 2015 has been for yields to fall to historically low levels as forecasts for inflation have repeatedly been revised downwards and expectations of increases in central rates have been pushed back. In addition, a notable trend in the year was that several central banks introduced negative interest rates as a measure to stimulate the creation of credit and hence economic growth.	
3.5.4	The European Central Bank commenced a full blown quantitative easing (QE) programme of purchases of Eurozone government and other bonds starting in March 2015 at €60bn per month. This put downward pressure on Eurozone bond yields. There was a further increase in this programme of QE in December 2015.	
3.5.5	As for America, the economy has continued to grow healthily on the back of resilient consumer demand. The first increase in the central rate occurred in December 2015 since when there has been a return to caution as to the speed of further increases due to concerns around the risks to world growth. The UK elected a majority Conservative Government in May 2015, removing one potential concern but introducing another due to the promise of a	

	referendum on the UK remaining part of the EU. The government maintained its tight fiscal policy stance but the more recent downturn in expectations for economic growth has made it more difficult to return the public sector net borrowing to a balanced annual position within the period of this parliament.
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:

	2014/15 £m	2015/16 £m
General Reserves	4.000	9.112
Earmarked Reserves	40.888	38.851
Provisions	1.441	1.088
Useable Capital Receipts	1.502	1.626
Total	47.831	50.677

3.6.3	Investments Held by the PCC - The PCC maintained an average balance of £52.701m of internally managed funds which compares with budget assumption of £41.398m as per the annual Treasury Management Strategy. The difference between the budget and actual position is explained by slippage of capital programme schemes into 2016/17 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 0.40% compared to a budget assumption of 0.30%. The comparable performance indicator is the average 7-day LIBID rate, which was 0.36%. The budget assumption of 0.30% average, return reflected no increase in the bank base rate but a slightly different mix of investments split between the Debt Management Office, Local Authorities, Banks and Building Societies than that which actually transpired.
3.7	**Regulatory Framework, Risk and Performance**
3.7.1	The PCC's treasury management activities are regulated by a variety of professional codes and 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.	**NEXT STEPS**
4.1	A Treasury Management update report, reviewing performance for the first six months of 2015/16 will be presented to the Joint Audit Committee in December 2016.
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	Hywel Morgan, Senior Financial Accountant.
12.	**ANNEXES**
12.1	None.

Consultation:	**Tick to confirm (if applicable)**
Financial The Chief Finance Officer has been consulted on this proposal.	✓
OPCC The Chief of Staff has reviewed the request and is satisfied that it is correct and consistent with the PCC's plans and priorities.	✓
Legal The legal team have been consulted on this proposal.	**N/A**
Equalities The Equalities Officer has been consulted on this proposal.	**N/A**

Chief of Staff:
I have been consulted about the proposal and can confirm that financial, legal, equalities etc… advice has been taken into account in the preparation of this report. I am satisfied that this is an appropriate report to be submitted to the Police and Crime Commissioner for Gwent.
Signature: Siân Curley
Date:11/07/16

Police and Crime Commissioner for Gwent
I confirm that I have considered whether or not I have any personal or prejudicial interest in this matter and take the proposed decision in compliance with the Code of Conduct. The above request has my approval.
Signature: Jeff Cu[illegible]
Date: 12/7/16