| OFFICE OF THE POLICE & CRIME COMMISSIONER<br>OFFICE OF THE CHIEF CONSTABLE | |
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| **TITLE:** | **Treasury Management Annual Report 2019/20** |
| **DATE:** | **11th June 2020** |
| **TIMING:** | **Routine** |
| **PURPOSE:** | **For consideration** |

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| **1.** | **RECOMMENDATION** |
| 1.1 | That the Annual Treasury Management Activity Report and actual Prudential Indicators for 2019/20 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 2019/20 and the actual Prudential Indicators for 2019/20. |
| 2.5 | During 2019/20 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:<br><br>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<br><br>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 2019/20 Estimate of Capital expenditure is as per the Treasury Management Strategy for 2019/20.

| | 2018/19 Actual £m | 2019/20 Estimate £m | 2019/20 Actual £m |
|---|---|---|---|
| Total Capital Expenditure | 6.902 | 29.117 | 9.932 |
| Financed by: | | | |
| Capital Receipts | 0.000 | 0.000 | 0.000 |
| Capital Grants | 0.449 | 0.449 | 0.459 |
| Reserves | 2.459 | 27.093 | 6.578 |
| Revenue | 3.994 | 1.575 | 2.895 |
| Supported Borrowing | 0.000 | 0.000 | 0.000 |
| Increase/(decrease) in Capital Creditors | 0.000 | 0.000 | 0.000 |
| Total Financing | 6.902 | 29.117 | 9.932 |
| 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 2019/20 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.

| | 2018/19 Actual £m | 2019/20 Estimate £m | 2019/20 Actual £m |
|---|---|---|---|
| Capital Financing Requirement | 4.511 | 0 | 0 |

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| 3.2.5 | On the 31st January 2020 the PFI contract for Ystrad Mynach was terminated and the finance lease liability was fully repaid, therefore, the actual CFR at the end of 2019/20 is zero. |
| **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 2020 compared with previous year comparators was:

| | 31st March 2019 | | 31st March 2020 | |
|---|---|---|---|---|
| | 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 | 40.149 | 0.9 | 38.122 | 0.9 |
| Variable Interest Investments | 9.005 | 0.8 | 3.500 | 0.5 |
| Total Investments | 49.154 | | 41.622 | |
| Cash & Cash Equivalents | 5.425 | | 3.608 | |
| Net Borrowing | (54.579) | | (45.230) | |

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| **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 <u>Gross Borrowing and the CFR</u>

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 2019/20 plus the expected changes to the CFR over 2020/21 and 2021/22 etc. The table below highlights the PCC's gross borrowing position against the CFR.

| | 2018/19 Actual £m | 2019/20 Estimate £m | 2019/20 Actual £m |
|---|---|---|---|
| Gross Borrowing (incl. PFI) | 4.511 | 0 | 0 |
| External Borrowing (excl. PFI) | 0 | 0 | 0 |
| Capital Financing Requirement (CFR) | 4.511 | 0 | 0 |

3.4.3 The above table shows that gross debt is exactly the same as the CFR (both zero) and therefore this prudential indicator has been met and reflects the Commissioner's decision to repay all external borrowing during 2016/17 and to terminate the PFI contract in 2019/20.

3.4.4 <u>The Authorised Limit</u>

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 at 3.4.7 demonstrates that during 2019/20 the PCC maintained gross borrowing within the Authorised Limit.

3.4.5 <u>The Operational Boundary</u>

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 <u>Maximum Gross Borrowing</u>

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

3.4.7 <u>Average Gross Borrowing</u>

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

| | 2019/20 £m |
|---|---|
| Authorised Borrowing Limit | 10,940 |
| Operational Boundary | 4.511 |
| Actual Maximum Gross Borrowing Position | 0 |
| Average Gross Borrowing Position | 2.256 |
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| Estimated Financing Costs as a % of Net Revenue Stream | (0.24%) |
| Actual Financing Costs as a % of Net Revenue Stream | (0.41%) |

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| 3.4.8 | <u>Actual financing costs as a proportion of Net Revenue Stream</u><br>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 £129.030m.<br><br>Actual Financing costs as a % of NRS is a negative, as all external debt was settled in 2016/17 and 2019/20. The actual percentage is higher than the estimated value due to slippage of capital programme schemes into 2020/21 and beyond. In addition, the actual interest rate received on investments was higher than forecast. |
| **3.5** | **Economic Background and Interest Rates** |
| 3.5.1 | The major landmark event of the year in the UK up until the start of 2020 was the issue of Brexit. This was settled by the decisive result of the general election in December and the conclusion of the UK leaving the EU on 31st January. However, this still leaves a trade deal to be agreed by the end of 2020. |
| 3.5.2 | Since January, the economic landscape of the UK, and the whole world, has been transformed by the coronavirus outbreak. While this had a huge impact in China in February/March due to the lockdown of the country bringing a sharp reduction in economic activity, a similar impact is now migrating around the world as the virus spreads. The UK, USA and much of Europe were therefore heading into a similar lockdown in March/April, which will cause Gross Domestic Product (GDP) growth to plunge in quarter 2 of 2020. This crisis resulted in government bond yields and Public Works Loan Board (PWLB) borrowing rates plunging in March. However, prior to this, there had been a general overall trend of a fall in gilt yields through 2019/20. This was primarily caused by growing investor concerns that the major economies of the world were heading into a decline in GDP growth and possibly into recession; with the growing trade war between China and the US being a prime cause of investor concern. In the US, this prompted the Federal Reserve to start cutting rates from the high point of 2.25%/2.50% reached in December 2018, by 0.25% in each of July, September and October 2019. Once coronavirus started to significantly impact the US, the Federal Reserve then took decisive action by cutting rates twice by 0.50% and then 1.00% in March 2020, all the way down to 0.00%/0.25%. Near the end of March 2020, Congress also agreed a $2 trillion stimulus package (worth about 10% of GDP) and new lending facilities announced by the Federal Reserve, which could channel up to $6 trillion in temporary financing to consumers and firms over the coming months. Despite all this action to support the US economy, treasury yields plunged to unprecedented lows during March 2020. |
| 3.5.3 | This story has been replicated in the UK during March 2020, with massive Government interventions to provide financial support to businesses, employees and the self-employed, coupled with assistance to banks to lend to businesses during the period of lock down. The Bank of England also intervened during March 2020, with two emergency cuts in Bank Rate from 0.75% down to 0.10%, plus £200 billion of additional quantitative easing purchases of bonds and various measures, to expand liquidity in financial markets. Despite all this intervention, gilt yields also plunged to unprecedented lows. |

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| 3.5.4 | The European Central Bank (ECB) drew a final halt to its quantitative purchases in December 2018 and was expecting to make a start on raising rates in 2019. However, growth became weak in the major Euro Zone economies towards the end of 2018 and more so in 2019. The ECB has therefore had to rapidly backtrack, by providing further stimulus via cheap financing during 2019 before it too, had to take emergency action in March 2020. |
| 3.5.5 | The overall trend during 2019 was for PWLB rates to be on a falling trend up until HM Treasury unexpectedly and without warning, increased the margin over gilts for PWLB borrowing, by 1% across the board. There was then a partial reversal of that increase in March 2020 for some borrowing for specified types of capital expenditure. PWLB rates then fell to unprecedented lows in March 2020. |
| **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, except on two occasions. In August 2019 (as reported in the mid-year Treasury Management Update Report), Members were notified that due to an unexpected Internet interruption on the 7th August 2019, the Assistant Accountant was unable to transfer funds to a Money Market Fund that day. This resulted in the Commissioner retaining funds in the bank account (£5.5m), in excess of the level determined in the Treasury Management Strategy (£2m). This minor breach of the Commissioner's Treasury Management Strategy was rectified the following day. In December 2019, the bank account balance exceeded the £5m threshold by approximately £200k overnight. Remedial action did not take place on the day the breach was discovered, as it was too late to move funds by the time the relevant personnel were notified. The PCC's Chief Finance Officer and the Assistant Chief Officer (Resources) were informed immediately and staff were reminded about the actions that need to occur when the bank balance exceeds the threshold. |
| 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: |
| 3.6.3 | Investments Held by the PCC - The PCC concluded the year with a balance of £41.622m of internally managed funds, which compares with a budget assumption of £30.672m as per the annual Treasury Management Strategy. |

| | 2018/19 £m | 2019/20 £m |
|---|---|---|
| General Reserves | 4.000 | 4.000 |
| Earmarked Reserves | 49.004 | 39.609 |
| Provisions | 1.491 | 1.417 |
| Useable Capital Receipts | 2.306 | 2.498 |
| Total | 56.801 | 47.524 |

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| | The difference between the budget and actual position is explained by slippage of capital programme schemes into 2019/20 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 0.9% compared to a budget assumption of 0.54%. The comparable performance indicator is the average 7-day LIBID rate, which was 0.15% at the close of the financial year. The budget assumption of 0.54% 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 | The PCC's treasury management activities are regulated by a variety of professional codes, statutes and guidance:<br>a) CIPFA's Treasury Management Code of Practice (2017 Edition);<br>b) CIPFA Guide for Chief Financial Officers on Treasury Management in Local Authorities;<br>c) CIPFA Standard of Professional Practice on Treasury Management;<br>d) The Prudential Code for Capital Finance in Local Authorities (2017 Edition);<br>e) Local Government Act 2003;<br>f) Bank of England Non Investment Products Code (2011);<br>g) Standing Orders relating to Contracts;<br>h) Financial Standing Orders, Regulations and Procedures;<br>i) The Commissioner's Manual of Corporate Governance and Scheme of Delegation; and<br>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 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 that 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 2020/21, will be presented to the Joint Audit Committee in December 2020. |
| **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** |

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| 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. |