OFFICE OF THE POLICE & CRIME COMMISSIONER OFFICE OF THE CHIEF CONSTABLE	
TITLE:	**Treasury Management Annual Report 2018/19**
DATE:	**3rd June 2019**
TIMING:	**Routine**
PURPOSE:	**For consideration**

1.	**RECOMMENDATION**
1.1	That the Annual Treasury Management Activity Report and actual Prudential Indicators for 2018/19 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 2018/19 and the actual Prudential Indicators for 2018/19.
2.5	During 2018/19 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 2018/19 Estimate of Capital expenditure is as per the Treasury Management Strategy for 2018/19.

	2017/18 Actual £m	2018/19 Estimate £m	2018/19 Actual £m
Total Capital Expenditure	1.588	23.269	6.902
Financed by:			
Capital Receipts	0.000	0.000	0.000
Capital Grants	0.449	0.449	0.449
Reserves	0.564	22.245	2.459
Revenue	0.575	0.575	3.994
Supported Borrowing	0.000	0.000	0.000
Increase/(decrease) in Capital Creditors	0.000	0.000	0.000
Total Financing	1.588	23.269	6.902
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 2018/19 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.

	2017/18 Actual	2018/19 Estimate	2018/19 Actual

	£m	£m	£m
Capital Financing Requirement	4.686	0	4.511

3.2.5 The 2018/19 actual CFR of £4.511 solely equates to the finance lease liability within the PFI contract for Ystrad Mynach. At the start of 2018/19 the CFR originally was estimated to be zero due to the assumption that the PFI contract would be voluntarily terminated by the end of the 2018/19 financial year. However, it is estimated that the early repayment of the PFI provision will take place in the first half of 2019/20, therefore the CFR was adjusted to £4.511 to reflect the value of the finance lease liability at the end of the 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 2019 compared with previous year comparators was:

	31st March 2018		31st March 2019	
	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	44.068	0.47	40.149	0.90
Variable Interest Investments	7.003	0.44	9.005	0.80
Total Investments	51.071		49.154	
Cash & Cash Equivalents	12.246		5.425	

Net Borrowing	(63.317)		(54.579)	

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 2018/19 plus the expected changes to the CFR over 2019/20 and 2020/21 etc. The table below highlights the PCC's gross borrowing position against the CFR.

	2017/18 Actual £m	2018/19 Estimate £m	2018/19 Actual £m
Gross Borrowing (incl. PFI)	4.686	0	4.511
External Borrowing (excl. PFI)	0	0	0
Capital Financing Requirement (CFR)	4.686	0	4.511

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 2018/19 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.

	2018/19

	£m
Authorised Borrowing Limit	17,757
Operational Boundary	10.684
Actual Maximum Gross Borrowing Position	4.511
Average Gross Borrowing Position	4.599
Estimated Financing Costs as a % of Net Revenue Stream	(0.18%)
Actual Financing Costs as a % of Net Revenue Stream	(0.36%)

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 £123.522m.

Actual Financing costs as a % of NRS is a negative as all external debt was settled in 2016/17. The actual percentage is higher than the estimated value due to slippage of capital programme schemes into 2019/20 and beyond. In addition actual interest rate received on investments was higher than forecast.

3.5 Economic Background and Interest Rates

3.5.1 The journey towards Brexit has been this year's landmark event in the UK and with the addition of world developments, caused a large impact on borrowing rates. During this year there has been a shift in the central banks of the US, UK and Euro Zone (EZ) to unwind money stimulus measures required to deal with the financial crash of 2008. The combination of the unwinding of these measures along with other factors, such as President Trump's tariff war with China, caused a downturn in economic growth. The European Central Bank (ECB) has backtracked on the unwinding of the money stimulus measure, as the forecasts showed further weakening in the growth rate and cheap financing was made available to banks in the EZ to stimulate economic growth. The overall picture is that growth has taken a downturn in the three biggest world economies in the US, EZ and China all at the same time. In the US there were nine consecutive increases in the Federal Rate which caused increases in borrowing rates peaking in early November 2018; since then borrowing interest rates have fallen to a lower level in March. In the UK, gilts and Public Works Loan Board rates have been subject to the same trend and rates have moved in the same direction during the course of the year.

3.5.2 In line with Base Rate increase expectations, investment interest rates saw a rising trend from the end of May until August, when the Monetary Policy Committee (MPC) raised the Bank of England Base Rate in line with expectations from 0.5% to 0.75%. Since then short term rates have flat lined, whereas longer term rates up to one year have increased after the MPC meeting of 1st November 2018, where there were concerns around the potential of rising inflation and needing to take possible action to raise rates more quickly than expected. Since mid-January, the frustrations of the Brexit saga have had a depressing effect on interest rate expectations and so the longer term rates have reduced.

3.5.3 On the 21st March the MPC voted unanimously to keep the base rate at 0.75%. The MPC are unlikely to take any action to raise the Bank Rate further until after there is positive progress in agreeing a form of Brexit, but it was implied by Governor Mark Carney that in the case of a long Brexit extension, the MPC may raise rates the summer.

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 one occasion in November 2018 where the maximum investment limit for an AAA counterparty was breached for six weeks by £2m. The investment overlap was discovered on the same day the investment was made and the PCC's Chief Finance Officer was contacted immediately for a decision on how to rectify. One option was to unwind the one investment early losing £2k of interest so there was no breach, or breaching the limit for six weeks until the planned repayment date. Due to the low risk of the counter party (a Local Authority) it was decided to breach the limit for 6 weeks. The PCC had no liquidity difficulties during this period.

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:

	2017/18 £m	2018/19 £m
General Reserves	4.000	4.000
Earmarked Reserves	52.131	49.004
Provisions	1.142	1.491
Useable Capital Receipts	1.735	2.306
Total	59.008	56.801

3.6.3 Investments Held by the PCC - The PCC concluded the year with a balance of £49.154m of internally managed funds which compares with a budget assumption of £32.716m 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 0.89% compared to a budget assumption of 0.39%. The comparable performance indicator is the average 7-day LIBID rate, which was 0.73%. 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	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 (2017 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 (2017 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).
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 2019/20 will be presented to the Joint Audit Committee in December 2019.
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.