OFFICE OF THE POLICE AND CRIME COMMISSIONER
FOR HUMBERSIDE
DECISION RECORD

Decision Record Number **35/2017**
Title: **Annual Treasury Management Report 2016/17**

Executive Summary: The Annual Treasury Management Report for 2016/17 submitted for approval.

Decision: That the Annual Treasury Management Report 2016/17 be approved.

Background Report: Open

Police and Crime Commissioner for Humberside I confirm I have considered whether or not I have any personal or prejudicial interest in this matter and take the proposed decision in compliance with my code of conduct. Any such interests are recorded below. The above decision has my approval.	
Signature	**Date 27.09.17**

HUMBERSIDE
POLICE & CRIME
COMMISSIONER

Police and Crime Commissioner for Humberside

Annual Treasury Management Review Report 2016/17

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1. Background

The Police and Crime Commissioner (PCC) is required by regulations issued under the Local Government Act 2003 to produce an annual treasury management review of activities and the actual prudential and treasury indicators for each financial year. This report for 2016/17 meets the requirements of both the CIPFA Code of Practice on Treasury Management (the Code), and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

During 2016/17 the minimum reporting requirements were that the PCC should receive the following reports:

- an annual treasury management strategy statement (TMSS) in advance of the year (approved 21 March 2016)
- a mid-year treasury update report (approved 6 March 2017)
- an annual review following the end of the year describing the activity compared to the strategy (this report)

The regulatory environment places responsibility on the PCC for the review and scrutiny of treasury management policy and activities. This report is, therefore, important in that respect, as it provides details of the outturn position for treasury activities and highlights compliance with the policy and strategy previously approved by the PCC.

The Treasury Management Strategy Statement was considered by the previous Joint Independent Audit Committee (JIAC) on 11 March 2016 prior to approval by the PCC. In the absence of a functioning JIAC during the financial year, the mid-term review report was reported directly to the PCC. The newly appointed JIAC considered this report prior to submission to the PCC for approval. A briefing on treasury management issues for the PCC and new JIAC members was held on 16 August 2017 in order to inform the PCC and support members in their scrutiny role.

2. Executive Summary

During 2016/17 all legislative and regulatory requirements were complied with. The key actual prudential and treasury indicators detailing the impact of capital expenditure activities during the year, with comparators are:

Prudential and treasury indicators	2015/16 Actual £000	2016/17 Original £000	2016/17 Actual £000
Capital expenditure	4,627	13,819	4,933
Capital Financing Requirement	59,933	68,671	59,360
Gross borrowing: External debt	31,947	40,467	29,207
Investments*	9,650	1,000	3,200
Net borrowing	22,297	39,467	26,007

**All investments were held for less than one year in line with the PCC's agreed policy.*

Other prudential and treasury indicators are to be found in the main body of the report.

The financial year 2016/17 continued the challenging investment environment of previous years, namely low investment returns.

3. Introduction

The PCC operates a balanced budget, which broadly means cash raised during the year will meet cash expenditure. Part of the treasury management operations ensure cash flows are adequately planned, with surplus monies being invested in low risk counterparties, providing adequate liquidity initially before considering optimising investment return.

The second main function of the treasury management service is the funding of the PCC's capital plans. These capital plans provide a guide to the PCC's borrowing need, essentially the longer term cash flow planning to ensure that capital spending operations can be met. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses, and on occasion restructuring any debt previously drawn to meet the PCC's risk or cost objectives.

This Annual Review has been prepared in compliance with CIPFA's Code of Practice on Treasury Management and summarises the following:

- Capital activity during the year,
- Impact of this activity on the PCC's underlying need to borrow (the Capital Financing Requirement),
- The actual prudential and treasury indicators,
- Overall treasury position identifying if and how the PCC has borrowed and the impact on investment balances,
- Summary of interest rate movements in the year,
- Detailed debt activity, and
- Detailed investment activity.

4. The Economy and Interest Rates

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 23 June 2016 and the election of President Trump in the USA on 9 November 2016. The first event had an immediate impact in terms of market expectations of when the first increase in the Bank Rate would happen, pushing it back from quarter 3 2018 to quarter 4 2019. At its 4 August 2016 meeting, the Monetary Policy Committee (MPC) cut the 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 the 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 designed to reinforce the transmission of Bank Rate cuts to those interest rates actually faced by households and businesses. It operates as part of the Asset Purchase facility, the quantative easing arrangement potentially providing £100bn of cheap financing to be made available to banks.

In the second half of 2016, the UK economy confounded the Bank's pessimistic forecasts of August 2016. 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 the Bank Rate again after August 2016 but, since then, inflation has risen rapidly due to the effects of the sharp devaluation of sterling after the referendum.

5. Capital Expenditure

The PCC undertakes capital expenditure on long-term assets. These activities may either be:

- Financed immediately through the application of capital or revenue resources (capital receipts, capital grants, revenue contributions etc.), which has no resultant impact on the PCC's borrowing need, or

- If insufficient financing is available, or a decision is taken not to apply resources, the capital expenditure will give rise to a borrowing need.

The actual capital expenditure forms one of the required prudential indicators. The table below shows the actual capital expenditure and how this was financed:

Capital Expenditure	2015/16 Actual £000	2016/17 Estimate £000	2016/17 Actual £000
Capital expenditure	4,627	13,819	4,933
Financed in year	2,938	1,078	2,818
Unfinanced capital expenditure	1,689	12,741	2,115

The original capital programme for 2016/17 was £13.8m. The outturn position shows total capital expenditure of £4.9m, a variation of £8.9m. The reasons for the main variations are:

Estates – delay in works at Force Headquarters, Hessle Police Station and Force Training Centre and saving on asbestos removal at Queens Garden Police Station.

IT – Slippage in the roll out of contact management and CONNECT criminal Justice programmes.

Vehicles and Equipment – saving on vehicle fuelling infrastructure work.

6. Overall Treasury Position as at 31 March 2017

The PCC's debt and investment position is organised by the treasury management team in order to ensure adequate liquidity for revenue and capital expenditure, security for investments and to manage risks within all treasury management activities. Procedures and controls to achieve these objectives are well established both through member reporting, and through officer activity detailed in the PCC's Treasury Management Practices Statement (TMPS). At the beginning and the end of 2016/17 the PCC's treasury position was as follows:

	31 March 2016 Principal £'000	Rate/ Return %	Average Life yrs	31 March 2017 Principal £'000	Rate/ Return %	Average Life yrs
Public Works Loan Board	31,947	3.36	6.46	29,207	3.36	5.87
Total debt	*31,947*			*29,207*		
Capital Financing Requirement	*59,933*			*59,360*		
Over / (under) borrowing	*(27,986)*			*(30,153)*		
Total investments*	*9,650*	*0.58*		*3,200*	*0.46*	
Net debt	22,297			26,007		

**All investments were held for less than one year in line with the PCC's agreed policy.*

The maturity structure of the debt portfolio was as follows:

	31 March 2016 Actual £000	31 March 2017 Actual £000
Under 12 months	2,740	2,426
12 months and within 24 months	2,426	3,404
24 months and within 5 years	10,193	10,114
5 years and within 10 years	13,803	10,731
10 years and over	2,785	2,532
Total	**31,947**	**29,207**

7. The Strategy for 2016/17

The expectation for interest rates within the TMSS for 2016/17 anticipated a low but rising Bank Rate, (starting in quarter 1 of 2017) and gradual rises in medium and longer term fixed borrowing rates during 2016/17. Variable, or short-term rates, were expected to be the cheaper form of borrowing over the period. Continued uncertainty in the aftermath of the 2008 financial crisis promoted a cautious approach, whereby investments would continue to be dominated by low counterparty risk considerations, resulting in relatively low returns compared to borrowing rates.

In this scenario, the treasury strategy was to postpone borrowing to avoid the cost of holding higher levels of investments and to reduce counterparty risk.

During 2016/17 there was major volatility in the Public Works Loan Board (PWLB) rates with rates falling during quarters 1 and 2 to reach historically very low levels in July and August, before rising significantly during quarter 3, and then partially easing back towards the end of the year.

8. The Borrowing Requirement and Debt

The PCC's underlying need to borrow to finance capital expenditure is termed the Capital Financing Requirement (CFR). The CFR results from the capital activity of the PCC and resources used to pay for the capital spend. Part of the PCC's treasury activities is to address the funding requirements for this borrowing need. Depending on the capital expenditure programme, the treasury management team organise the PCC's cash position to ensure that sufficient cash is available to meet the capital plans and cash flow requirements. This may be sourced through borrowing from external bodies (such as the Government, through the PWLB or the money markets), or utilising temporary cash resources held by the PCC.

Reducing the CFR – the PCC's underlying borrowing need (CFR) is not allowed to rise indefinitely. Statutory controls are in place to ensure that capital assets are broadly charged to revenue over the life of the asset. The PCC is required to make an annual revenue charge, called the Minimum Revenue Provision – MRP, to reduce the CFR. This is effectively a repayment of the borrowing need. This differs from the treasury management arrangements which ensure that cash is available to meet capital commitments. External debt can also be borrowed or repaid at any time, but this does not change the CFR.

The PCC's 2016/17 MRP Policy (as required by CLG Guidance) was approved as part of the TMSS for 2016/17. The PCC's CFR for the year is shown below, and represents a key prudential indicator:

	31 March 2016 Actual £000	31 March 2017 Budget £000	31 March 2017 Actual £000
Opening Balance	60,849	59,933	59,933
Add unfinanced capital Expenditure	1,689	12,741	2,115
Less MRP	2,605	4,003	2,688
Closing Balance	59,933	68,671	59,360

Gross borrowing and the CFR - in order to ensure that borrowing levels are prudent over the medium term and only for a capital purpose, the PCC should ensure that gross external borrowing does not, except in the short term, exceed the total of the capital financing requirement in the preceding year, 2015/16, plus the estimates of any additional capital financing requirement for the current 2016/17 and next two financial years. This essentially means that the PCC is not borrowing to support revenue expenditure. The table below highlights the PCC's gross borrowing position against the CFR. The PCC has complied with this prudential indicator:

	31 March 2016 Actual £000	31 March 2017 Budget £000	31 March 2017 Actual £000
Gross borrowing position	31,947	40,467	29,207
CFR	59,933	68,671	59,360

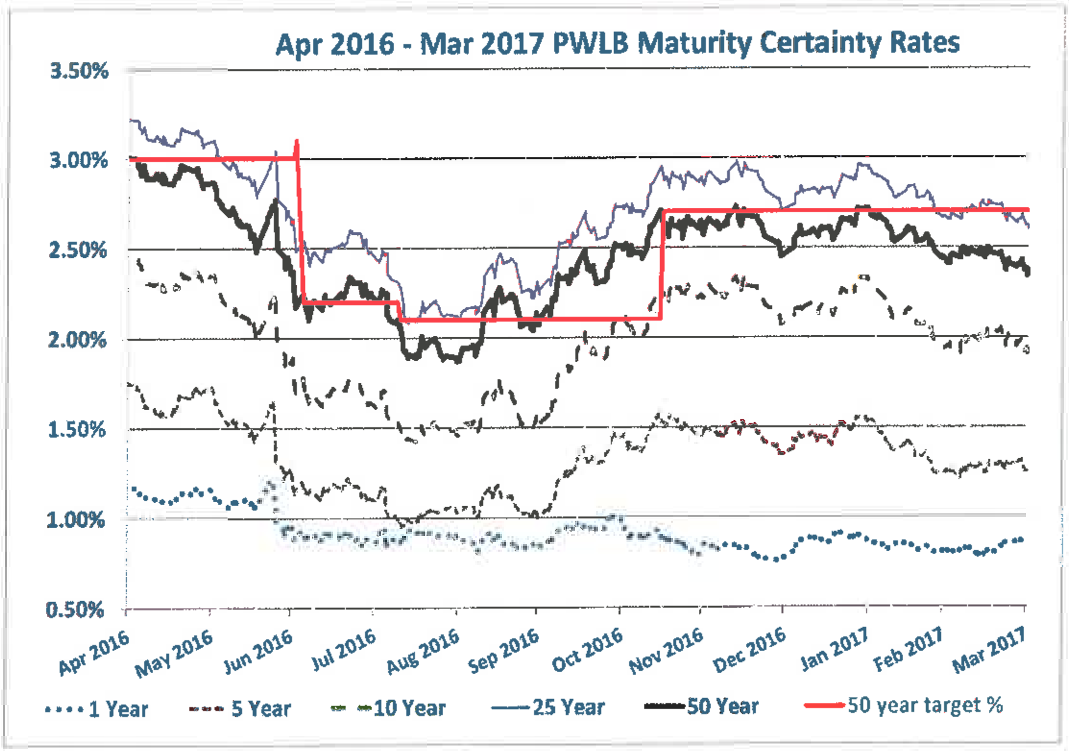
The authorised limit - the authorised limit is the "affordable borrowing limit" required by s3 of the Local Government Act 2003. Once this has been set, the PCC does not have the power to borrow above this level. The table below demonstrates that during 2016/17 the PCC has maintained gross borrowing within its authorised limit.

The operational boundary – the operational boundary is the expected borrowing position of the PCC during the year. Periods where the actual position is either below or over the boundary is acceptable subject to the authorised limit not being breached.

	2016/17
Authorised limit	£78.804m
Maximum gross borrowing position	£34.986m
Operational boundary	£76.804m

9. Borrowing Rates in 2016/17

PWLB certainty maturity borrowing rates - The graph below shows how PWLB certainty rates have fallen to historically very low levels during the year:



10. Borrowing Outturn for 2016/17

Borrowing – Due to investment concerns, both counterparty risk and low investment returns, no borrowing was undertaken during the year.

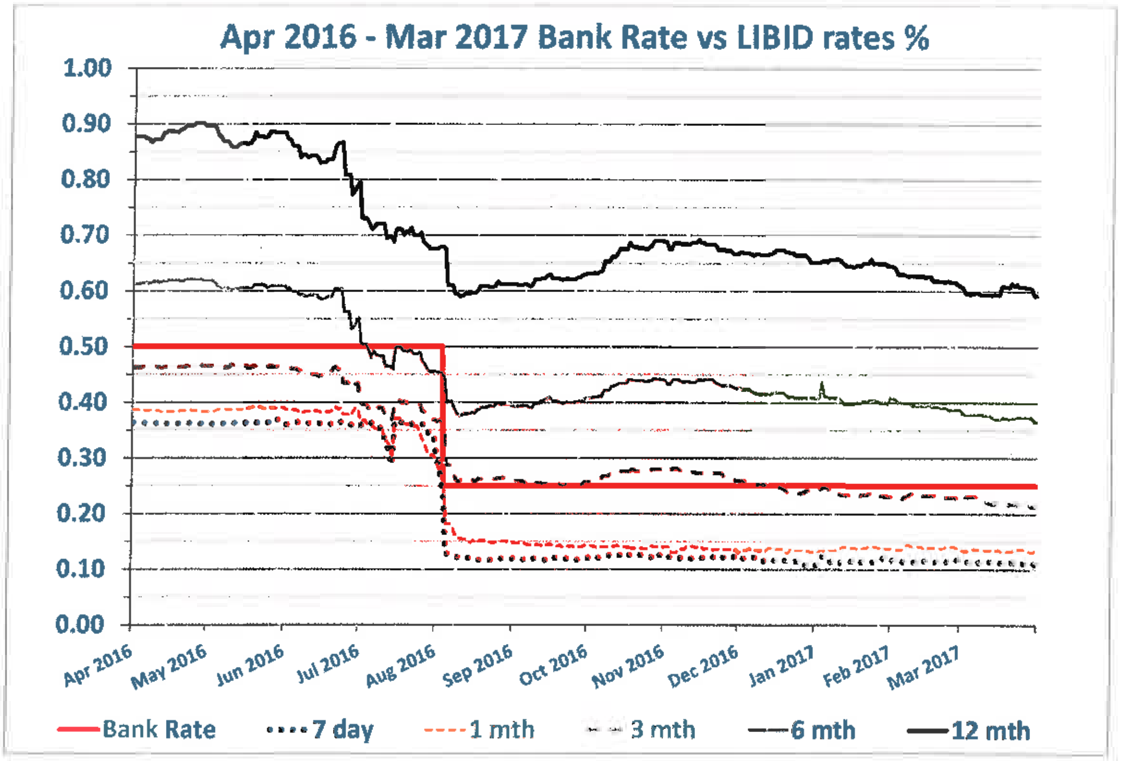
Rescheduling - No rescheduling was done during the year as the average 1% differential between PWLB new borrowing rates and premature repayment rates made rescheduling unviable.

Repayments - The PCC repaid £2.740m at an average rate of 3.34 % during the financial year, in line with the agreed repayment terms.

Summary of debt transactions – management of the debt portfolio resulted in an average interest rate of 3.36%, unchanged from 2015/16.

11. Investment Rates in 2016/17

After the EU referendum, the Bank Rate was cut from 0.5% to 0.25% on 4 August 2016 and remained at that level for the rest of the year. Market expectations as to the timing of the start of monetary tightening started the year at quarter 3 2018, but then moved back to around the end of 2019 in early August before finishing the year back at quarter 3 2018. Deposit rates continued into the start of 2016/17 at previous depressed levels but then fell during the first two quarters and fell even further after the 4 August 2016 MPC meeting resulting in a large tranche of cheap financing being made available to the banking sector by the Bank of England. Rates made a weak recovery towards the end of 2016 but then fell to fresh lows in March 2017.



12. Investment Outturn for 2016/17

Investment Policy – the PCC's investment policy is governed by CLG guidance, which has been implemented in the TMSS approved by the PCC. This policy sets out the approach for choosing investment counterparties, and is based on credit ratings provided by the three main credit rating agencies, supplemented by additional market data, (such as rating outlooks, credit default swaps, bank share prices etc.).

The investment activity conformed to the approved strategy with no breaches during the year.

Investments held by the PCC – The PCC held £3.200m of investments as at 31 March 2017 (£9.650m at 31 March 2016) and the investment yield for this period was 0.46%. The comparable performance indicator is the average 7-day LIBID rate, which was 0.20%.

In 2015/16 the counter party limits were revised and these revised limits remained in place for 2016/17 with no breaches to report. The limits are:

- UK Part Nationalised Banks – £20m with any one institution and £25m with any one banking group.

- Other Counterparties - £15m with any one institution and £25m with any one banking group.

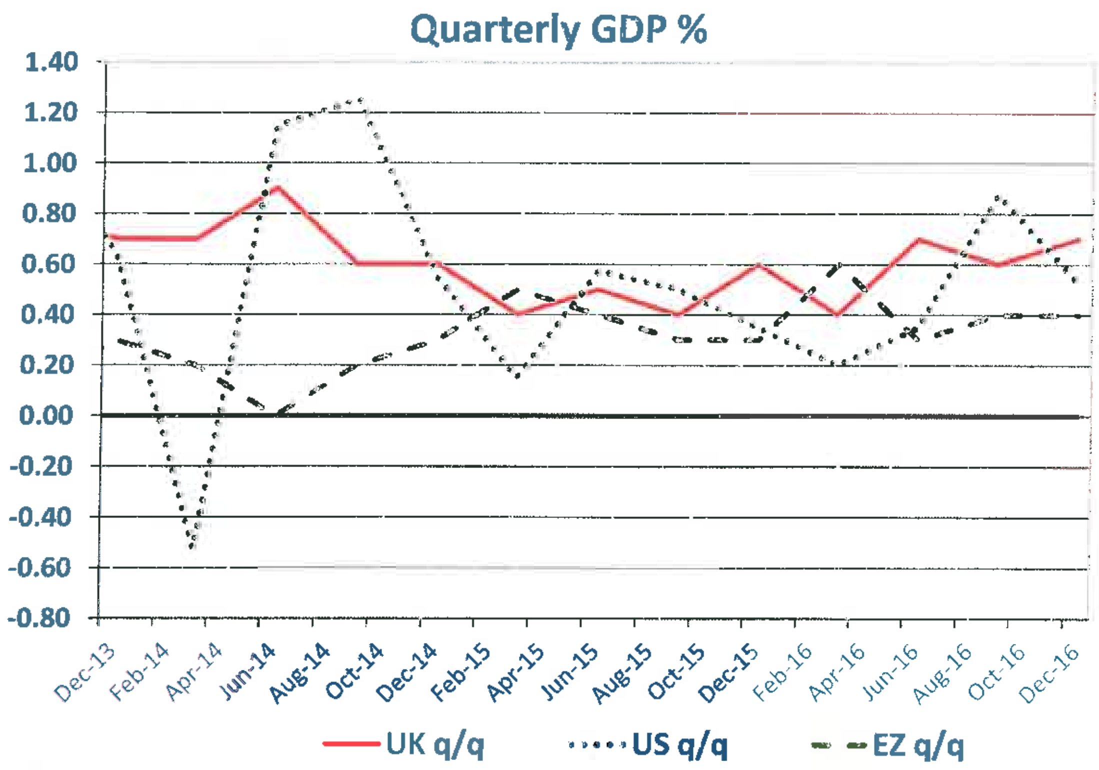
Appendix 1: Prudential and treasury indicators

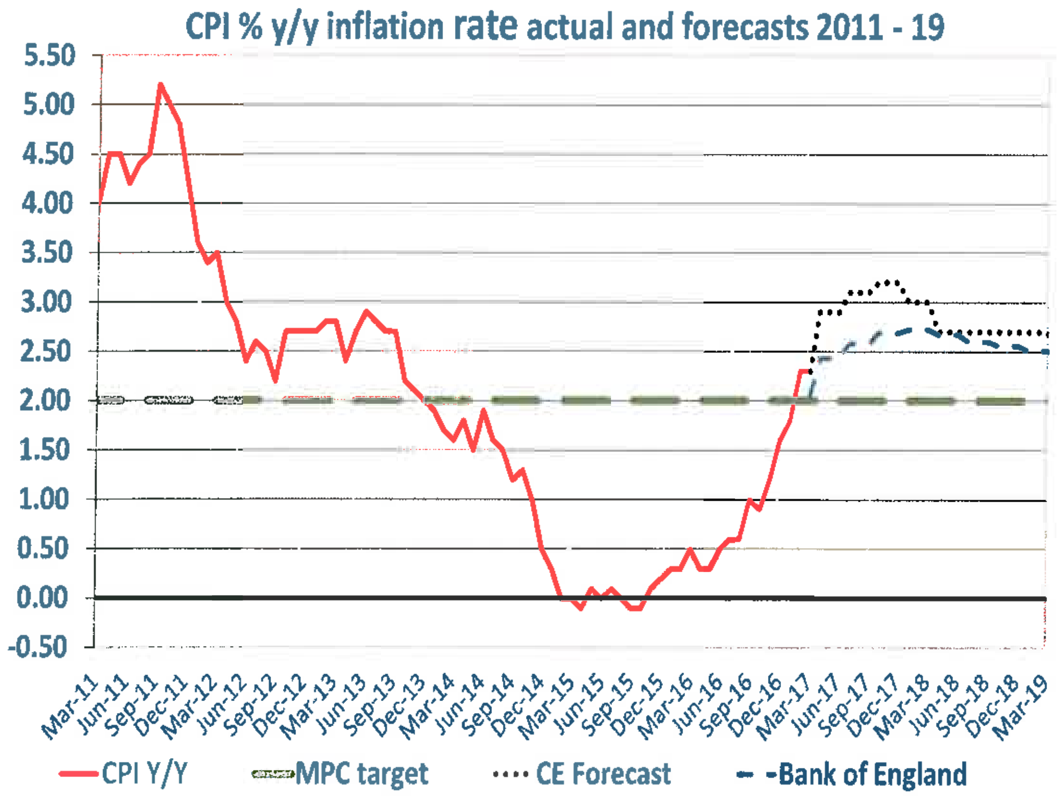
1. PRUDENTIAL INDICATORS	2015/16	2016/17	2016/17
	actual	original	actual
	£'000	£'000	£'000
Capital Expenditure			
TOTAL	£4,627	£13,819	£4,933
Ratio of financing costs to net revenue stream	2.10%	2.85%	2.15%
Gross borrowing requirement			
brought forward 1 April	£34,986	£31,947	£31,947
Loans repaid in year	-£3,039	-£2,740	-£2,740
carried forward 31 March	£31,947	£40,467	£29,207
in year borrowing requirement	-£3,039	£8,,520	-£2,740
Gross debt	£31,947	£40,467	£29,207
CFR TOTAL	£59,933	£68,671	£59,360
Annual change in Cap. Financing Requirement			
TOTAL	- £916	£8,738	-£573
Incremental impact of capital investment decisions	£ 1.96 p	£ 3.16p	-£1.52p

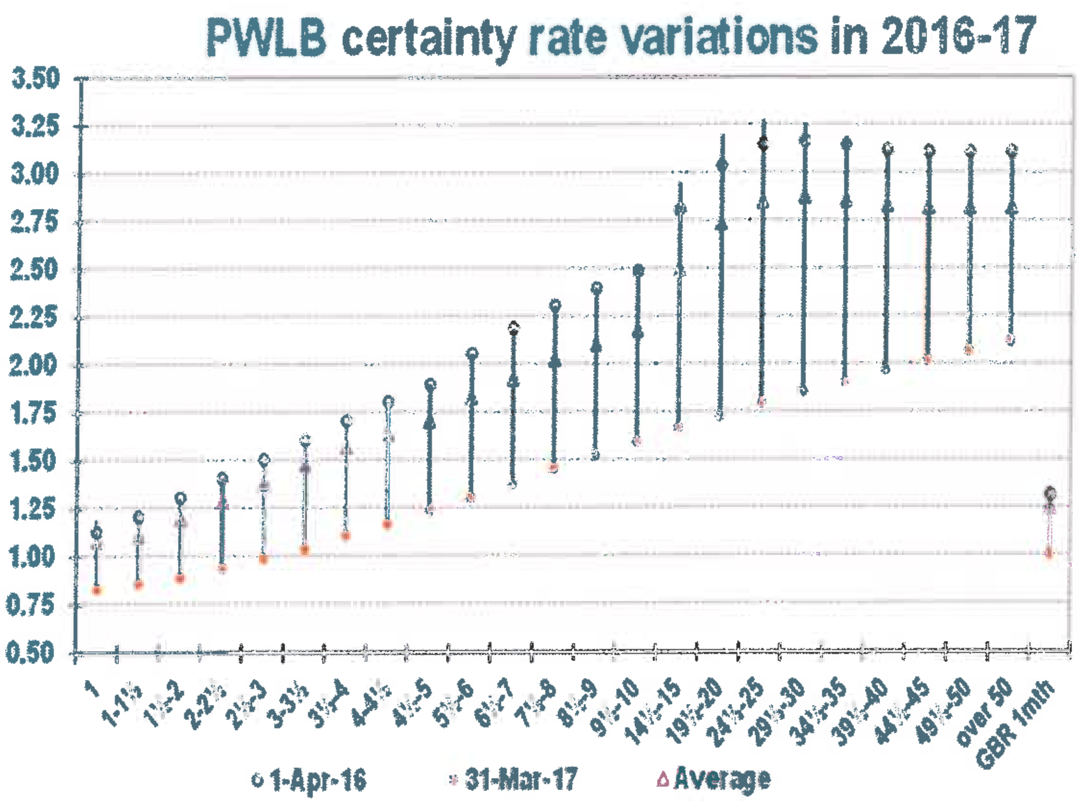
2. TREASURY MANAGEMENT INDICATORS	2015/16	2016/17	2016/17
	actual	original	actual
	£'000	£'000	£'000
Authorised Limit for external debt -			
borrowing	£62,898	£70,260	£78,804
other long term liabilities	£0	£0	£0
TOTAL	£62,898	£70,260	£78,804
Operational Boundary for external debt -			
borrowing	£60,898	£68,260	£76,804
other long term liabilities	£0	£0	£0
TOTAL	£60,898	£68,260	£76,804
Actual external debt	£31,947	£40,467	£29,207
Upper limit for fixed interest rate exposure	£60,000	£70,000	£78,000
Upper limit for variable rate exposure	£29,500	£35,000	£39,000

Maturity structure of fixed rate borrowing during 2016/17	upper limit	lower limit	Actual
under 12 months	50 %	0 %	8.31%
12 months and within 24 months	75%	0 %	11.68%
24 months and within 5 years	80 %	0 %	34.60%
5 years and within 10 years	80 %	0 %	36.74%
10 years and above	100 %	0 %	8.67%

Appendix 2: Graphs







	1	1-1.5	2.5-3	3.5-4	4.5-5	9.5-10	24.5-25	49.5-50	1 month variable
1/4/16	1.130%	1.160%	1.330%	1.470%	1.620%	2.310%	3.140%	2.950%	1.310%
31/3/17	0.830%	0.860%	0.990%	1.110%	1.240%	1.600%	1.800%	2.070%	1.010%
High	1.200%	1.250%	1.460%	1.630%	1.800%	2.510%	3.280%	3.080%	1.350%
Low	0.760%	0.800%	0.840%	0.880%	0.950%	1.420%	2.080%	1.870%	1.040%
Average	0.928%	0.961%	1.104%	1.226%	1.361%	2.007%	2.724%	2.494%	1.150%
Spread	0.440%	0.450%	0.620%	0.750%	0.850%	1.090%	1.200%	1.210%	0.310%
High date	27/04/2016	27/04/2016	27/04/2016	27/04/2016	27/04/2016	27/04/2016	27/04/2016	27/04/2016	20/05/2016
Low date	20/12/2016	15/03/2017	10/08/2016	10/08/2016	10/08/2016	10/08/2016	12/08/2016	30/08/2016	30/11/2016

	1 Year	5 Year	10 Year	25 Year	50 Year
1/4/16	1.13%	1.62%	2.31%	3.14%	2.95%
31/3/17	0.83%	1.24%	1.60%	1.80%	2.07%
Low	0.76%	0.95%	1.42%	2.08%	1.87%
Date	20/12/2016	10/08/2016	10/08/2016	12/08/2016	30/08/2016
High	1.20%	1.80%	2.51%	3.28%	3.08%
Date	27/04/2016	27/04/2016	27/04/2016	27/04/2016	27/04/2016
Average	0.93%	1.36%	2.01%	2.72%	2.49%

Money market investment rates 2016/17

	7 day	1 month	3 month	6 month	1 year
1/4/16	0.363	0.386	0.463	0.614	0.877
31/3/17	0.111	0.132	0.212	0.366	0.593
High	0.369	0.391	0.467	0.622	0.902
Low	0.107	0.129	0.212	0.366	0.590
Average	0.200	0.220	0.315	0.462	0.702
Spread	0.262	0.262	0.255	0.256	0.312
High date	27/5/16	21/6/16	10/5/16	22/4/16	26/4/16
Low date	28/12/16	21/12/16	30/3/17	31/3/17	10/8/16