

**OFFICE OF THE POLICE AND CRIME COMMISSIONER
FOR HUMBERSIDE
DECISION RECORD**

Decision Record Number 22/2019

Title: **Annual Treasury Management Report 2018/19**

Executive Summary:

The Annual Treasury Management Report for 2018/19 was considered by the Joint Independent Audit Committee at its meeting on 7 June 2019 where it was recommended to the PCC. The report is submitted for formal approval.

Decision:

That the Annual Treasury Management Report 2018/19 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

24-6-19



HUMBERSIDE
POLICE & CRIME
COMMISSIONER



**Police and Crime Commissioner for
Humberside**

Annual Treasury Management Review
2018/19

Annual Treasury Management Review 2018/19

1. Introduction

This 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 2018/19. This report 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 2018/19 the minimum reporting requirements were that the PCC should receive the following reports:

- an annual treasury strategy Statement in advance of the year (31 March 2018)*
- a mid-year treasury review report (18 December 2018)*
- 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 previously approved by the PCC.

This PCC confirms that the requirement under the Code to give prior scrutiny to all of the above treasury management reports by the Joint Independent Audit Committee (JIAC) before they were reported to him were complied with. Member training on treasury management was undertaken in 2017 in order to support members' scrutiny role and further training sessions are in the process of being arranged.

2. The PCC's Capital Expenditure and Financing

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.

<i>£'000</i>	<i>2017/18 Actual</i>	<i>2018/19 Actual</i>
Capital expenditure	15,171	14,518
Financed in year	1,870	1,163

Unfinanced capital expenditure	13,307	13,355
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3. The PCC's Overall Borrowing Need

The PCC's underlying need to borrow to finance capital expenditure is termed the Capital Financing Requirement (CFR).

Gross borrowing and the CFR - in order to ensure that borrowing levels are prudent over the medium term and borrowing is 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 (2017/18) plus the estimates of any additional capital financing requirement for the current (2018/19) and next two financial years. This essentially means that the PCC is not borrowing to support revenue expenditure. This indicator allowed the PCC some flexibility to borrow in advance of immediate capital needs in 2018/19. The table below highlights the PCC's gross borrowing position against the CFR. The PCC has complied with this prudential indicator.

£'000	31 March 2018 Actual	31 March 2019 Actual
CFR	70,680	80,892
Gross borrowing position	45,281	65,377
Under funding of CFR	25,399	15,515

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 2018/19 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 are acceptable subject to the authorised limit not being breached.

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.

£'000	2018/19
Authorised limit	87,121
Maximum gross borrowing position during the year	65,377
Operational boundary	85,121
Financing costs as a proportion of net revenue stream	2.55%

4. Treasury Position as at 31 March 2019

At the beginning and the end of 2018/19 the PCC's treasury position (excluding finance leases) was as follows:

The

DEBT PORTFOLIO £'000	31 March 2018 Principal	Rate/ Return	Average Life yrs	31 March 2019 Principal	Rate/ Return	Average Life yrs
Fixed rate funding:						
-PWLB	41,281	2.94%	5.68	65,377	2.61%	7.34
Variable rate funding:						
-Market	4,000	0.80%	N/A	-	-	-
Total debt	45,281			65,377		
CFR	70,680			80,892		
Over / (under) borrowing	25,399			15,515		
Total investments	3,800	0.40%	N/A	2,265	0.65%	N/A

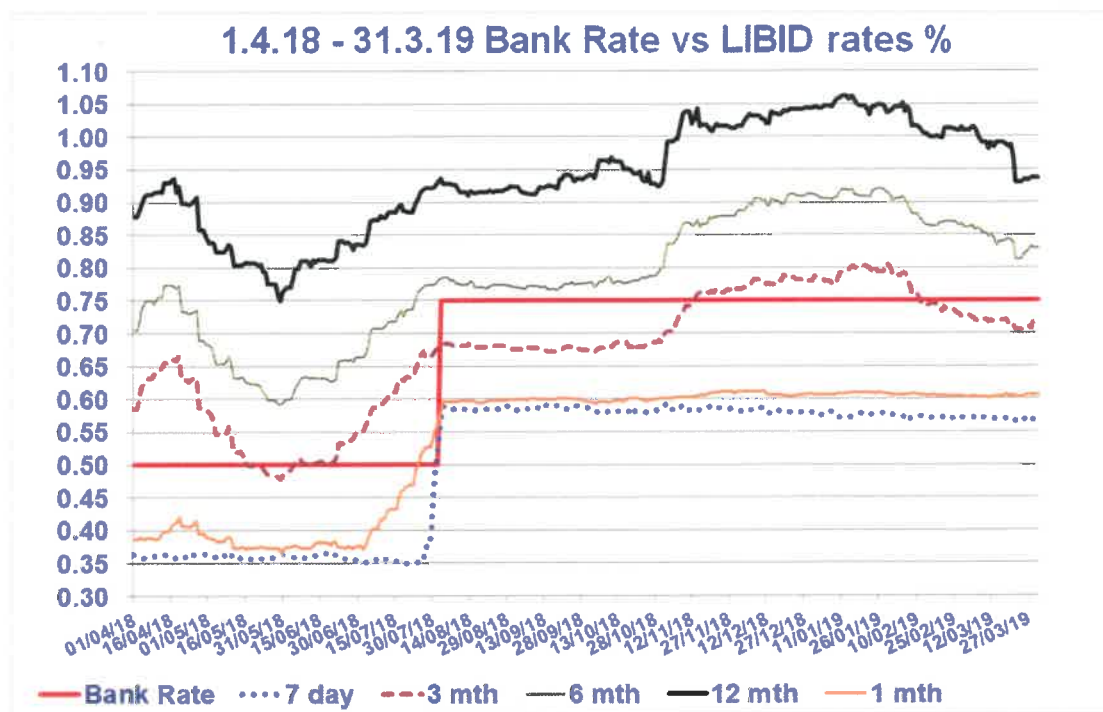
maturity structure of the PWLB debt portfolio was as follows:

£'000	31 March 2018 actual	31 March 2019 actual
<i>Under 12 months</i>	3,404	3,658
<i>12 months and within 24 months</i>	3,411	3,131
<i>24 months and within 5 years</i>	9,969	10,123
<i>5 years and within 10 years</i>	11,647	17,185
<i>10 years and over</i>	12,850	31,280

The maturity structure of the investment portfolio is detailed below. The investments were all with UK banks. This is in line with the policy of not lending monies for longer than one year.

	<i>2017/18 Actual £000</i>	<i>31 March 2019 Actual £000</i>
<i>Investments Up to 1 year</i>	<i>3,800</i>	<i>2,265</i>

Investment strategy and control of interest rate risk



Investment returns remained low during 2018/19. The expectation for interest rates within the treasury management strategy for 2018/19 was that Bank Rate would rise from 0.50% to 0.75%. At the start of 2018-19, and after UK GDP growth had proved disappointingly weak in the first few months of 2018, the expectation for the timing of this increase was pushed back from May to August 2018. Investment interest rates were therefore on a gently rising trend in the first half of the year after April, in anticipation that the MPC would raise Bank Rate in August. This duly happened at the MPC meeting on 2 August 2018.

It was not expected that the MPC would raise Bank Rate again during 2018-19 after August in view of the fact that the UK was entering into a time of major uncertainty with Brexit due in March 2019.

Investment rates were little changed during August to October but rose sharply after the MPC meeting of 1 November was unexpectedly hawkish about their perception of building inflationary pressures, particularly from rising wages. However, weak GDP growth data after December, plus increasing concerns generated by Brexit, resulted in investment rates falling back again.

The PCC had limited cash balances for much of the year and so was unable to place deposits for more than one to three months to earn higher rates from longer deposits. However, when Bank Rate went up in August, investment returns improved from deposits for these shorter periods.

Continued uncertainty in the aftermath of the 2008 financial crisis has 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.

4.2 Borrowing strategy and control of interest rate risk

During 2018-19, an under-borrowed position was once again maintained. This meant that the capital borrowing need, (the Capital Financing Requirement), was not fully funded with loan debt, as cash supporting the PCC's reserves, balances and cash flow was used as an interim measure. This strategy was prudent as investment returns were low and minimising counterparty risk on placing investments also needed to be considered.

A cost of carry remained during the year on any new long-term borrowing that was not immediately used to finance capital expenditure, as it would have caused a temporary increase in cash balances; this would have incurred a revenue cost – the difference between (higher) borrowing costs and (lower) investment returns.

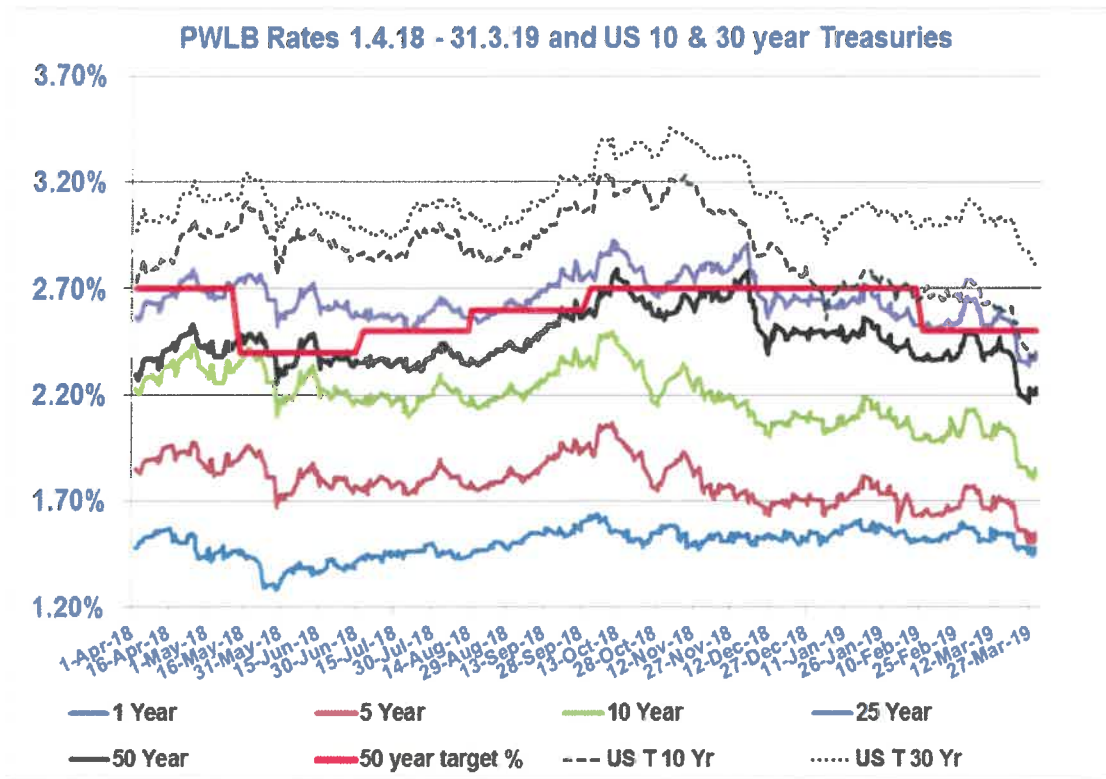
The policy of avoiding new borrowing by running down spare cash balances, has served well over the last few years. However, this was kept under review to avoid incurring higher borrowing costs in the future when the PCC may not be able to avoid new borrowing to finance capital expenditure and/or the refinancing of maturing debt.

Against this background and the risks within the economic forecast, caution was adopted with the treasury operations. The Deputy Chief Executive and Treasurer therefore monitored interest rates in financial markets and adopted a pragmatic strategy based upon the following principles to manage interest rate risks:

- if it had been felt that there was a significant risk of a sharp FALL in long and short term rates, (e.g. due to a marked increase of risks around relapse into recession or of risks of deflation), then long term borrowings would have been postponed, and potential rescheduling from fixed rate funding into short term borrowing would have been considered.
- if it had been felt that there was a significant risk of a much sharper RISE in long and short term rates than initially expected, perhaps arising from an acceleration in the start date and in the rate of increase in central rates in the USA and UK, an increase in world economic activity or a sudden increase in inflation risks, then the portfolio position would have been re-appraised, with fixed rate funding being drawn down whilst interest rates were lower than they were projected to be in the next few years.

Interest rate forecasts expected only gradual rises in medium and longer term fixed borrowing rates during 2018/19 and the two subsequent financial years. Variable, or short-term rates, were expected to be the cheaper form of borrowing over the period.

Link Asset Services Interest Rate View													12.2.18	
	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	
Bank Rate	0.50%	0.75%	0.75%	1.00%	1.00%	1.00%	1.00%	1.25%	1.25%	1.25%	1.50%	1.50%	1.50%	
5yr PWLB Rate	1.90%	2.00%	2.10%	2.10%	2.20%	2.30%	2.30%	2.40%	2.40%	2.50%	2.50%	2.60%	2.60%	
10yr PWLB Rate	2.50%	2.50%	2.60%	2.70%	2.70%	2.80%	2.80%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%	
25yr PWLB Rate	2.80%	2.90%	3.00%	3.10%	3.20%	3.20%	3.30%	3.30%	3.40%	3.50%	3.50%	3.60%	3.60%	
50yr PWLB Rate	2.60%	2.70%	2.80%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%	3.30%	3.30%	3.40%	3.40%	



Since PWLB rates peaked during October 2018, most rates were on a general downward trend, though longer term rates did spike upwards again during December, and, (apart from the 1 year rate), reached lows for the year at the end of March. There was a significant level of correlation between movements in US Treasury yields and UK gilt yields -which determine PWLB rates. In America the Fed increased rates four times in 2018, making nine increases in all in this cycle, to reach 2.25% – 2.50% in December. However, it had been giving forward guidance that rates could go up to nearly 3.50%. These rate increases and guidance caused Treasury yields to also move up. However financial markets considered by December 2018, that the Fed had gone too far, and discounted its expectations of further increases. Since then, the Fed has also come round to the view that there are probably going to be no more increases in this cycle. The issue now is how many cuts in the Fed Rate there will be and how soon, in order to support economic growth in the US. But weak growth now also looks to be the outlook for China and the EU so this will mean that world growth as a whole will be weak. Treasury yields have therefore fallen sharply during 2019 and gilt yields / PWLB rates have also fallen and at the end of the financial year there were opportunities to take advantage of competitive rates due to the impact of increasing uncertainty over Brexit.

5. Borrowing Outturn

Borrowing

Loans were drawn down during the year to fund the net unfinanced capital expenditure and naturally maturing debt as follows:

<i>Date</i>	<i>Lender</i>	<i>Principal</i>	<i>Type</i>	<i>Interest Rate %</i>	<i>Maturity</i>
14/02/2019	PWLB	1,000,000	Maturity	2.00	14/02/2029
14/02/2019	PWLB	2,000,000	Maturity	1.85	14/02/2027
27/02/2019	PWLB	2,000,000	Maturity	2.41	27/02/2036
27/02/2019	PWLB	2,000,000	Maturity	2.01	27/02/2029
27/02/2019	PWLB	2,500,000	Maturity	2.49	27/02/2039
12/03/2019	PWLB	2,000,000	Maturity	2.41	12/03/2037
12/03/2019	PWLB	2,000,000	Maturity	2.44	12/03/2038
12/03/2019	PWLB	1,000,000	Maturity	2.13	12/03/2031
12/03/2019	PWLB	1,000,000	Maturity	2.07	12/03/2030
12/03/2019	PWLB	1,000,000	Maturity	2.00	12/03/2029
15/03/2019	PWLB	1,000,000	Maturity	1.73	15/03/2025
15/03/2019	PWLB	2,000,000	Maturity	2.37	15/03/2035
25/03/2019	PWLB	1,000,000	Maturity	1.87	25/03/2028
25/03/2019	PWLB	1,000,000	Maturity	2.14	25/03/2033
25/03/2019	PWLB	1,000,000	Maturity	2.23	25/03/2035
25/03/2019	PWLB	1,000,000	Maturity	2.27	25/03/2036
26/03/2019	PWLB	1,000,000	Maturity	1.57	26/03/2024
26/03/2019	PWLB	1,000,000	Maturity	2.07	26/03/2032

26/03/2019	PWLB	1,000,000	Maturity	2.29	26/03/2037
26/03/2019	PWLB	1,000,000	Maturity	2.31	26/03/238
TOTAL		27,500,000	Average	2.18	

Borrowing in advance of need

The PCC did not borrow more than, or in advance of need, purely in order to profit from the investment of the extra sums borrowed.

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

During the year the PCC repaid PWLB loans totalling £3.404m which had an average rate of interest of 3.4%, together with the temporary borrowing at 1 April 2018 of £4m at 0.40%.

Summary of debt transactions – management of the debt portfolio resulted in a fall in the average interest rate of 0.33%.

6. Investment Outturn

Investment Policy – Investment policy is governed by MHCLG investment guidance, which has been implemented in the annual investment strategy approved by the PCC on 31 March 2019. 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 during the year conformed to the approved strategy, and the PCC had no liquidity difficulties.

Investments held by the PCC

- The internally managed funds earned an average rate of return of 0.55%.
- The comparable performance indicator is the average 7-day LIBID rate, which was 0.57%.

Non-treasury management investments. The PCC did not engage in any activities in 2018/19 in respect of non-treasury management investments.

Appendix 1: Prudential and treasury indicators

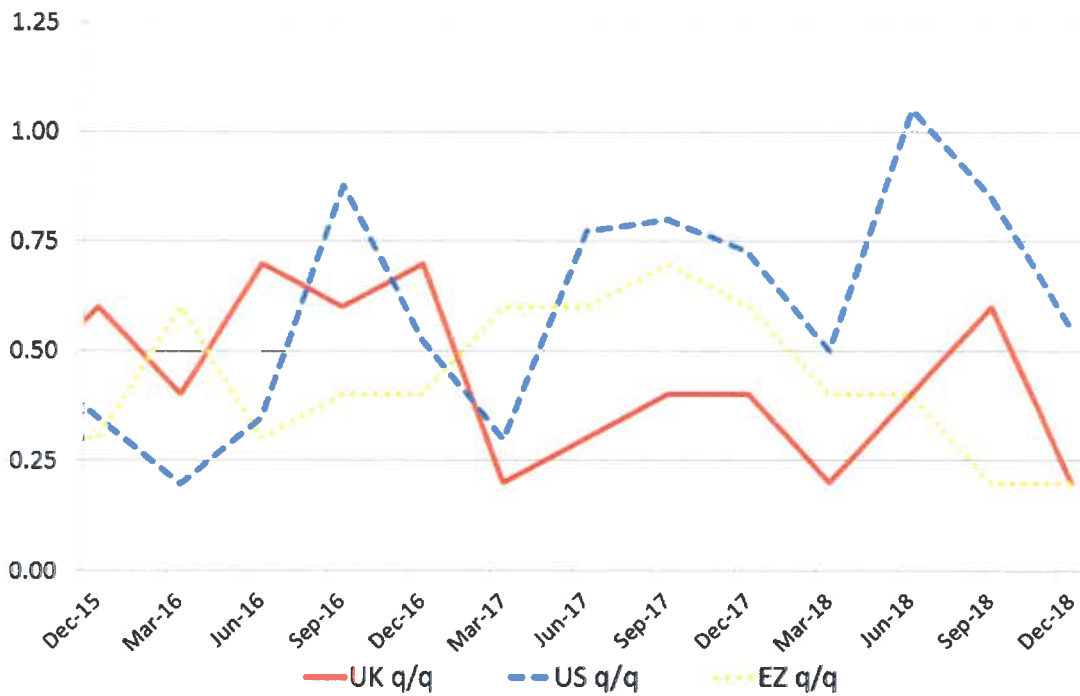
1. PRUDENTIAL INDICATORS	2017/18	2018/19
Extract from budget and rent setting report	actual	actual
	£'000	£'000
Capital Expenditure		
TOTAL	£15,177	£14,518
Ratio of financing costs to net revenue stream	1.73%	2.55%
Gross borrowing		
brought forward 1 April	£29,207	£45,281
carried forward 31 March	£45,281	£65,377
in year borrowing less loans repaid	£16,074	£20,096
Gross debt	£45,281	£65,377
CFR	£70,680	£80,892
Annual change in Cap. Financing Requirement	£11,320	£10,212

Maturity structure of fixed rate borrowing at 31 March 2019 (£'000)	Limit	2017/18		2018/19	
under 12 months	50%	£3,404	8.3%	£3,658	5.6%
12 months and within 24 months	75%	£3,411	8.3%	£3,131	4.8%
24 months and within 5 years	80%	£9,969	24.1%	£10,123	15.5%
5 years and within 10 years	80%	£11,647	28.2%	£17,185	26.3%
10 years and over	100%	£12,850	31.1%	£31,280	47.8%

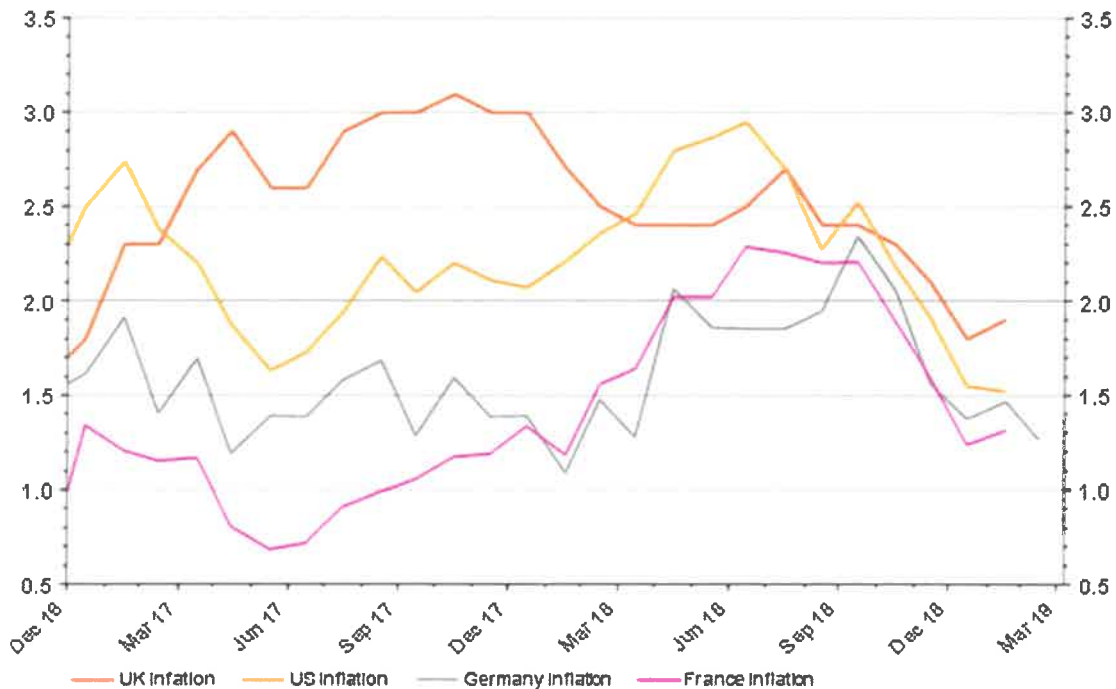
TOTAL		£41,281		£65,377	
Investments held at 31 March 2019					
under 12 months		£3,800		£2,265	

Appendix 2: Graphs

UK, US and EZ GDP growth



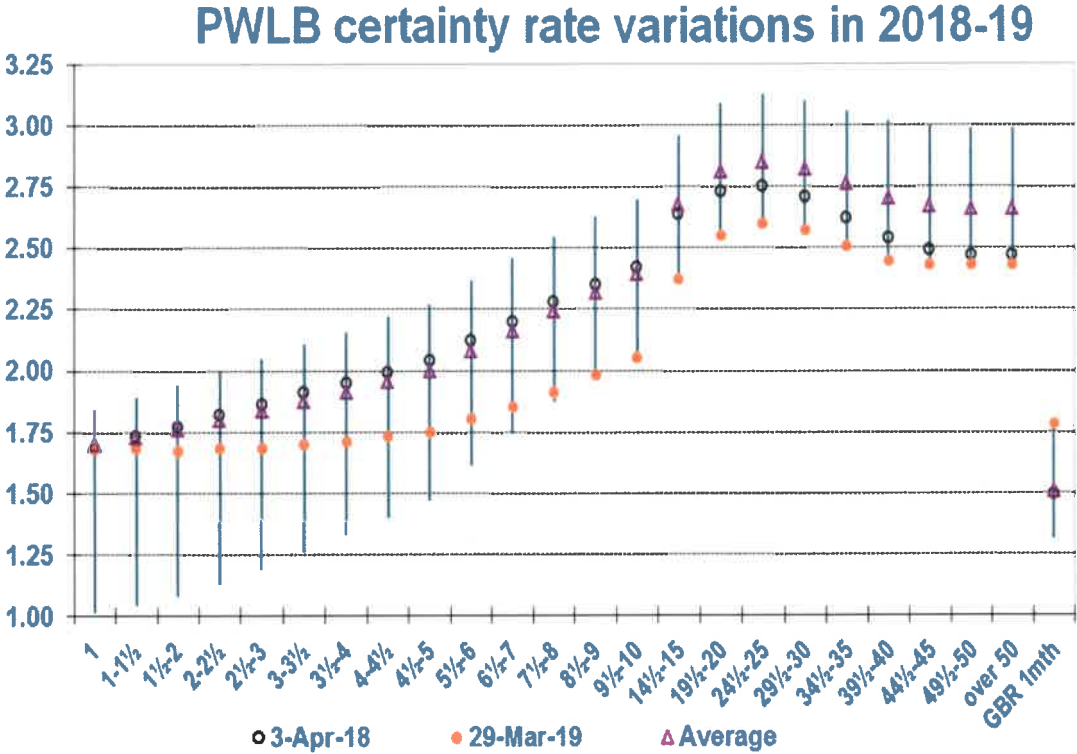
Inflation UK, US, Germany and France



Source: Thomson Reuters Datastream

Appendix 3: Borrowing and investment rates

PWLB borrowing rates



	1 Year	5 Year	10 Year	25 Year	50 Year
02/04/2018	1.48%	1.85%	2.23%	2.57%	2.29%
29/03/2019	1.48%	1.55%	1.85%	2.40%	2.23%
Low	1.28%	1.50%	1.80%	2.33%	2.16%
Date	29/05/2018	26/03/2019	28/03/2019	26/03/2019	26/03/2019
High	1.64%	2.07%	2.50%	2.93%	2.79%
Date	04/10/2018	10/10/2018	10/10/2018	10/10/2018	12/10/2018
Average	1.50%	1.80%	2.20%	2.66%	2.47%

Money Market Investment Rates

	Bank Rate	7 day	1 mth	3 mth	6 mth	12 mth
01/04/2018	0.50	0.36	0.39	0.59	0.70	0.88
31/03/2019	0.75	0.57	0.61	0.72	0.83	0.94
High	0.75	0.59	0.61	0.81	0.92	1.06
High Date	02/08/2018	01/11/2018	10/12/2018	29/01/2019	15/01/2019	11/01/2019
Low	0.50	0.35	0.37	0.48	0.59	0.75
Low Date	01/04/2018	19/07/2018	30/05/2018	30/05/2018	30/05/2018	30/05/2018
Average	0.67	0.51	0.54	0.68	0.79	0.94
Spread	0.25	0.24	0.25	0.33	0.33	0.31

