NORTHUMBRIA POLICE AND CRIME COMMISSIONER

Key Decisions

Title and Reference - (PCC/279/2017)

Treasury Management Annual Report 2016/17

Summary

The Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (the Code) requires the Commissioner to receive a Treasury Management Annual Report on borrowing and investment activity by 30 September each year. This report meets this requirement and informs the Commissioner of Treasury Management activity during 2016/17.

The report was reviewed by the Joint Independent Audit Committee at their meeting on 19 June 2017.

Recommendation/ Findings:

To approve the Treasury Management Annual Report 2016/17.

Northumbria Police and Crime Commissioner

I hereby approve the recommendation above.

Signature **Date 29.06.17**

OPCC Business Meeting	***22/06/17***
Treasury Management Annual Report 2016/17	
Report of: Mike Tait, Chief Finance Officer	
Author: Kevin Laing, Head of Finance	

1. PURPOSE

1.1 In line with the Code of Practice on Treasury Management this report presents to the Police and Crime Commissioner (PCC) the Treasury Management Annual Report 2016/17 for review and acceptance.

2. RECOMMENDATIONS

2.1 The Police and Crime Commissioner is asked to review the attached Treasury Management Annual Report 2016/17 and accept it as a true record of the activities for 2016/17.

3. BACKGROUND

3.1 The Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (the Code) requires the Commissioner to receive a Treasury Management Annual Report on borrowing and investment activity by 30 September each year. This report meets this requirement and informs the Commissioner of Treasury Management activity during 2016/17.

3.2 In line with good governance principles included within the Code, the attached Treasury Management Annual Report has been presented and reviewed by the Joint Independent Audit Committee on 19 June 2017.

4. KEY OUTCOMES

4.1 The Treasury Management Annual Report 2016/17 is attached at Appendix A. The key highlights are as follows:

- Borrowing costs were well under budget due to borrowing being taken at lower interest rates than estimated and the deference in external borrowing being taken by using existing internal cash resources.

- Investment income was under budget reflecting a cut in base rate in August 2016 reducing returns on investments. In addition, the strategy of deferring additional external borrowing to fund capital expenditure has resulted in lower balances available to invest.

- We have complied with our financial regulations, prudential indicators and treasury management policy as confirmed by Internal Audit.

5. CONSIDERATIONS

Government Protective Marking Scheme	*NOT PROTECTIVELY MARKED*
Freedom of Information	*NON-EXEMPT*
Consultation	*Yes*
Joint Independent Audit Committee on 19 June 2017	
Resource	*No*
Equality	*No*
Legal	*No*
Risk	*No*
Communication	*No*
Evaluation	*No*

Appendix A

Treasury Management Annual Report 2016/17

The Strategy for 2016/17

1. The 2016/17 Treasury Management Policy Statement and Strategy was approved by the Joint Independent Audit Committee on 22 February 2016 for presentation to the Police and Crime Commissioner (PCC). The key decision was approved by the PCC on 31 March 2016.

2. The formulation of the 2016/17 Treasury Management Strategy involved determining the appropriate borrowing and investment decisions with the prime objective of safeguarding assets and secondary objectives of managing liquidity, obtaining a reasonable rate of return on investments and minimising the costs of borrowing.

3. The Treasury Management Strategy fully complied with the requirements of The Chartered Institute of Public Finance and Accountancy Code of Practice on Treasury Management and covered the following:
    - Prospects for interest rates.
    - Treasury limits including prudential indicators.
    - The borrowing strategy.
    - The investment strategy.

Investment Strategy

4. Investments are managed using the counterparties listed in an approved lending list consistent with the agreed Treasury Management Strategy. Investments are placed over a range of periods and are dependent on the assessed security of the counterparty, the liquidity requirements of the cash flow, actual interest rates and expectations of movements in interest rates.

5 The expectation for interest rates within the Treasury Management Strategy for 2016/17 anticipated a low but increasing 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.

6 In this scenario, the Treasury Management Strategy was to postpone external borrowing to avoid the cost of holding higher levels of investments and to reduce counterparty risk.

7 During 2016/17 there was major volatility in 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.

Borrowing Strategy

8. The borrowing strategy for 2016/17 was:

    - Consider the use of short term borrowing as a bridge until receipts are received.
    - When PWLB rates fall back to or below Capita Asset Services trigger rates borrowing will be considered, with preference given to shorter terms to enhance the diversity of the borrowing portfolio.
    - Consideration was to be given to borrowing using market loans which were at least 20 basis points below the PWLB target rate.

9. The early repayment of debt was determined to achieve poor value during 2016/17 as the cost of premiums on the early repayment of debt was too high.

Treasury Management Compliance with Risk Strategy

10. The primary objective is to ensure the security of funds and minimise risks, including counterparty and interest rate risks. An Internal Audit review of the treasury management function in August 2016 gave the opinion that it was ‘Operating Well’.

Outturn 2016/17 – Performance Measurement

11. Prudential indicators are set annually to ensure that borrowing is prudent, sustainable and affordable. Performance is monitored against these indicators throughout the year and reported in the quarterly capital monitoring reports. The outturn against the prudential indicators confirms that all indicators were operating within agreed limits with no breaches throughout the year. For completeness a copy of the prudential indicators is attached as Appendix 1.

External Advisers

12. Capita Asset Services, Treasury Solutions have continued to be used as external treasury management advisers to assist in achieving the objectives set out in the Treasury Policy Statement and Strategy and provide access to specialist skills and resources.

Market Interest Rates

13. Performance must be considered in conjunction with actual rate movements over the financial year which were as follows:

Shorter-term interest rates

After the EU referendum, Bank Rate was cut from 0.5% to 0.25% on 4 August 2016 and stayed at that level for the remainder of the year.

Longer-term interest rates

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 2016 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 Monetary Policy Committee (MPC) meeting resulted 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.

Investment Performance

14. The major issue for treasury management in 2016/17 has continued to be ensuring the security of investments whilst generating a reasonable rate of return. Due to the difference between the cost of borrowing and investment interest and the reduction in suitable counterparties, cash balances have continued to be used to temporarily fund the capital programme. This has resulted in savings on the cost of borrowing and reduced credit risk as the investment portfolio has reduced.

15. Although investment activity during the year has been restricted due to the reduced number of counterparties, continued use has been made of a range of investment instruments in order to increase flexibility, spread risk, maximise liquidity and obtain attractive interest rates. An increased use of money market funds and notice reserve accounts, with high rated and UK Government supported banks, has maintained the security of funds and enhanced the rate of return on investments.

16. A summary of the year's activity is shown at Appendix 2. The total interest earned in the year, was £0.078m (2015/16 £0.349m) with an average interest rate of 0.43% (2015/16 0.49%). The investment interest earned was a decrease of £0.025m against the original budget of £0.103m.

17. The overall return on investments of 0.43% exceeds the accepted benchmark rate (the 7-day London Interbank Bid Rate (LIBID)) of 0.20%. The LIBID is used as a benchmark as it is linked to the base rate and provides a publically available national comparator. By actively managing our temporary investments, seeking the best rates and utilising spare capacity in certain accounts we have maximised the interest earned whilst operating within the constraints of the approved Treasury Management Policy.

Heritable Bank

18. The former Police Authority had a deposit of £5.2m invested in Heritable Bank, a wholly owned subsidiary of Icelandic Bank, Landsbanki, when it entered administration in October 2008. The full deposit in Heritable was due to mature by the end of 2008/09 with interest.

19. At the end of 2016/17, dividends totalling £5.194m (98.00p in the £) had been received, reflecting no further dividend in 2016/17. The dividend received to date overachieved against the estimated return of 90p in the £. As the original investment was impaired in 2010/11 to reflect the expected return, all

additional income above 90p in the £ is revenue income. The additional 8.00p in the £ equates to £0.540m revenue income.

20. The most recent update from the administrators, Ernst and Young, in March 2017, provided detail of all dividends received to date and advised that no further dividend is expected until the conclusion of the matter. Ernst and Young intend to report further on this matter in 2017/18.

Borrowing Performance

21. The total borrowing at 31 March 2017 was £99.465m, which was within the operational borrowing limit of £160m. This is a net decrease of £5.000m from the opening figure of £104.465m, represented by £75.000m new borrowing and repayments of £80.000m. The new borrowing was taken as follows:

Date	**Term**	**Amount**	**Interest Rate**	**Source**
01/04/2016	94 days	£5.000m	0.50%	Market Loan
29/04/2016	70 days	£5.000m	0.42%	Market Loan
29/04/2016	28 days	£2.000m	0.40%	Market Loan
27/05/2016	42 days	£10.000m	0.48%	Market Loan
16/06/2016	32 days	£10.000m	0.36%	Market Loan
25/11/2016	118 days	£5.000m	0.30%	Market Loan
23/12/2016	122 days	£10.000m	0.35%	Market Loan
03/01/2017	178 days	£5.000m	0.38%	Market Loan
02/02/2017	153 days	£6.000m	0.45%	Market Loan
02/02/2017	153 days	£2.000m	0.41%	Market Loan
02/03/2017	125 days	£5.000m	0.50%	Market Loan
22/03/2017	50 years	£5.000m	2.46%	PWLB
27/03/2017	49 years	£5.000m	2.37%	PWLB
		£75.000m		

22. The borrowing strategy during 2016/17 was to keep borrowing short term as the Commissioner is in the process of rationalising the estate and is expecting around £31m of receipts from the sale of assets over the term of the current Medium Term Financial Strategy (MTFS). This is delivering savings in the short term, but carries potential interest rate risk, if rates rise and there is a need to re-finance.

23. The average borrowing interest rate at 31 March 2017 was 3.45% compared to 3.26% at 31st March 2016. This reflects the short term/low rate borrowing taken in 2016/17. This delivers short term savings but carries potential interest rate risk, if rates rise and there is a requirement to re-finance.

24. At 31 March 2017, £66.465m of the total borrowing was from the PWLB with the remaining £33m taken from market loans.

The overall revenue cost of borrowing in 2016/17 was £3.132m. This was £1.073m less than the budget. The saving was due to the decision to delay borrowing by temporarily funding the capital programme using existing cash resources as well as external borrowing being taken at lower rates than estimated with to the majority of the borrowing being taken short term.

Debt Restructuring and Repayment

25. Due to the differential between current and historic interest rates it was anticipated that there would be little scope to restructure PWLB debt. This situation was monitored throughout the year and the cost of early repayment outweighed any savings and therefore there was no early redemption or restructuring of debt.

Summary of Treasury Management performance for the year 2016/17

26. Investment income was £0.025m under budget. The under achievement reflects a cut in base rate in August 2016 reducing returns on investments. In addition, a delay in taking borrowing to fund capital expenditure has resulted in lower balances available to invest.

27. Borrowing costs were £1.073m less than the budget. This is due to borrowing being taken at lower rates than estimated and the deference in borrowing being taken.

28. Overall Treasury Management performance against budget for 2016/17 generated a surplus of £1.048m as summarised in the following table:

	2016/17 Budget £m	**Actual £m**	**Saving £m**
Cost of Borrowing	4.205	3.132	(1.073)
Investment Income	(0.103)	(0.078)	0.025
Net Position	**4.102**	**3.054**	**(1.048)**

Prudential Indicators 2016/17

Authorised Limit for External Debt	
	2016/17 Reported Indicator £m
Borrowing	185.000
Other Long Term Liabilities	0
Total	**185.000**
Maximum YTD £126.465m	

Operational Boundary for External Debt	
	2016/17 Reported Indicator £m
Borrowing	160.000
Other Long Term Liabilities	0
Total	**160.000**
Maximum YTD £126.465m	

Limit on Fixed and Variable Interest Rates Exposures		
Range	**2016/17 Reported Indicator £000**	**2016/17 Outturn £000**
Fixed Rate	147.188 4.956	89.378 max 117.656 min 50.683
Variable	6.000 (45.000)	0.000 max 0.000 min (14.000)
All within agreed Limits (Max & Min YTD)		

Upper / Lower Limits for Maturity Structure of Fixed Rate Borrowing				
	2016/17 Reported Indicator		**2016/17 Outturn**	
	Upper Limit	**Lower Limit**	**Actual Percentage**	**Maximum YTD**
< 1yr	65%	0%	32.75%	51.40%
1 -2 yrs	50%	0%	5.95%	14.69%
2 – 5 yrs	50%	0%	5.03%	10.93%
5 – 10yrs	60%	0%	15.08%	21.87%
10 yrs >	75%	0%	41.19%	43.33%
All within agreed limits				

Upper Limit on amounts invested beyond 364 days			
	2016/17 Reported Indicator £m	**2016/17 Outturn £m**	**2016/17 Maximum YTD £m**
Investments	**15.000**	**0**	**0**

Investment Activity

Investments maturing during the year	2015/16	2016/17
Number of investments made in 2014/15 maturing in 2015/16	0	n/a
Number of investments made in 2015/16 maturing in 2015/16	1,022	n/a
Number of investments made in 2015/16 maturing in 2016/17	n/a	1
Number of investments made in 2016/17 maturing in 2016/17	n/a	1,245
Total number of investments maturing in year	1,022	1,246
Number of investments made in 2016/17 maturing in 2017/18	n/a	0

Average duration of investments	2015/16	2016/17
Average duration of investments (including overnight)	2 days	1 days
Average duration of investments (excluding overnight)	63 days	47 days

Summary of non-specified investments	2015/16	2016/17
Non-specified investments:		
Rated non-high		
Approved limit	55%	55%
Maximum level invested	63%**	23%
Not Rated		
Approved limit	0%	0%
Maximum level invested*	6%	6%
Investments over 364 days		
Approved limit	20%	20%
Maximum level invested	0%	0%

*Relates to impaired investment with Heritable Bank.

**Relates to a breach of one week only due to a deposit placed prior to an unforeseen change in ratings for Lloyds bank mid-week from a Government backed Bank to a Non-Government backed Bank.