Cumbria Office of the Police and Crime Commissioner

Title: Treasury Management Activities 2016/17 Quarter 1 (April to June 2016)

PCC Decision Meeting: September 2016

Joint Audit & Standards Committee: 07 September 2016

Originating Officers: Michelle Bellis, Deputy Chief Finance Officer and,

Lorraine Holme, Principal Financial Services Officer.

1. Purpose of the Report

1.1. The purpose of this paper is to report on the Treasury Management activities, which have taken place during the period April to June 2016, in accordance with the requirements of CIPFA's Code of Practice on Treasury Management.

1.2. Treasury Management activities are undertaken in accordance with the Treasury Management Strategy Statement and Treasury Management Practices approved by the Commissioner in February each year.

2. Recommendation

2.1. The Commissioner is asked to note the contents of this report. The report will also be presented to the Joint Audit and Standards Committee meeting of 07 September as part of the arrangements to ensure members are briefed on Treasury Management and maintain an understanding of activity in support of their review of the annual strategy.

2.2. JASC Members are asked to note the contents of this report. The report is provided as part of the arrangements to ensure members are briefed on Treasury Management and maintain an understanding of activity in support of their review of the annual strategy. The report will also be presented to the Commissioner at a decision meeting in September 2016.

3. Economic Background

3.1. As we entered 2016, there was a significant uncertainty about the outlook for global growth. The slowdown in the Chinese economy and the knock-on effects for both trading partners and commodity prices, the uncertainty over the outcome of the US presidential election (no clear party or candidate being identified as an outright winner) and the impending referendum on the UK's future relationship with the EU, all resulted in nervousness and a shaky start for markets.

Data released in the April-June quarter showed UK GDP at 2% year/year to March 2016 and annual inflation at 0.3% in May. Core inflation remained subdued as a consequence of weak global price pressures, past movements in sterling and restrained domestic price growth. Internationally, a modest pace of growth in the UK's main trading partners remained the most likely prospect.

Fluctuations in the opinion polls on the EU referendum prompted pronounced volatility in exchange rates, gilts, corporate bonds and equities as the result became increasingly uncertain. Immediately prior to the result, financial market sentiment shifted significantly in favour of a Remain outcome, a shift swiftly reversed as the results came in. The vote to leave the EU sent shockwaves through the domestic, European and global political spectrum.

Between 23rd June and 1st July the sterling exchange rate index fell by 9% and short-term volatility of sterling against the dollar increased significantly. Worldwide, markets reacted very negatively with a big initial fall in equity prices. Government bond yields also fell sharply by 20-30 basis points across all maturities (i.e. prices rose) as investors sought safe haven from riskier assets. The 10-year benchmark gilt yield fell from 1.37% to 0.86%. However, within a week of the EU referendum result the overall market reaction, although significant, was less severe than some had feared. The 5-year CDS for the UK (the cost of insuring against a sovereign default) rose from 33.5 basis points to 38.4 basis points. The FTSE All Share index, having fallen sharply by 7% from 3,481 points on 23rd June to 3,237 after the result, had subsequently risen to 3,515 by the end of the month.

3.2. The Bank of England sought to reassure markets and investors. Governor Mark Carney's speeches on 24th and 30th June in response to the referendum result stressed that the Bank was ready to support money market liquidity and raised the likelihood of a cut in policy rates 'in the summer'. The door was also left open for an increase in the Bank's asset purchase facility (QE). The Governor noted that the Bank would weigh the downside risks to growth against the upside risks to inflation from fall in the value of sterling.

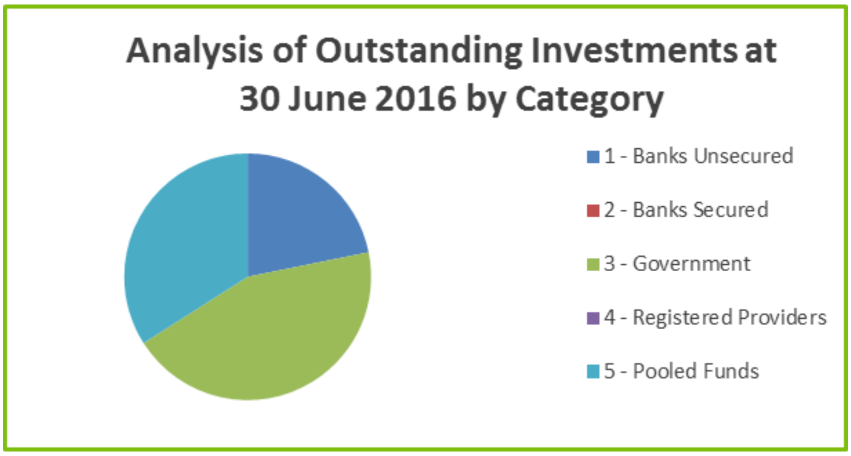
At the subsequent August meeting of the Bank of England's MPC, the decision was taken to reduce the bank base rate from 0.50% to a new all-time low level of 0.25%. The MPC also increased the level of asset purchases known as quantitative easing (QE) from £375bn to £425bn.

4. Treasury Management Operations and Performance Measures

4.1. The Commissioner's day to day treasury management activities are undertaken on behalf of the Commissioner's Chief Finance Officer/Deputy Chief Executive by the financial services team under the management of the Chief Constable's Chief Finance Officer. Responsibilities and requirements for treasury management are set out in the financial regulations and rules. Treasury management practices are approved annually setting out the arrangements as part of the Treasury Management Strategy Statement (TMSS).

The TMSS sets maximum limits for investments according to category. The categories and overall limit per category is illustrated in the table below together with the actual investments outstanding as at 30 June 2016. Within each category there are further limits to the total amount and duration of investments that can be placed with individual counterparties, these vary depending on the credit rating of the counterparty at the time the investment is made.

Category	Category Limit (£m)	Actual Investments at 30 June (£m)	Compliance with Limit
1 - Banks Unsecured	20	2.469	Yes
2 - Banks Secured	20	0.000	Yes
3 - Government	unlimited	5.000	Yes
4 - Registered Providers	10	0.000	Yes
5 - Pooled Funds	15	3.853	Yes
Total		**11.322**	



A schedule detailing the individual investments that make up the £11.322m total invested at 30 June 2016 is attached at **Appendix 2**. A further illustrative analysis is provided of the balance outstanding at **Appendix 3**, where the first chart analyses the outstanding balance by the credit rating of the investment counterparty and the second shows the maturity structure of investments by the credit rating of the counterparty.

4.2. Management of Cash Balances

The aim of the Treasury Management Strategy is to invest surplus cash and minimise the level of un-invested cash balances, whilst limiting risks to the Commissioner's funds. Actual un-invested balances for the months of April to June 2016 for the Commissioner's main bank account are summarised in the table below:

	Number of Days	Average Balance £	Largest Balance £
Days In Credit	87	62,409	1,603,080
Days Overdrawn	4	(131)	(432)

The bank account had large un-invested balances on two occasions. The largest un-invested balance occurred on the 10 June for three days over the weekend (£1.6m). This was as a result of an error by one of the constabulary's brokers. Investments were placed with Standard life (£1.6m) and Aberdeen asset management (£2m) on the 7 June 2016 via the broker.

The broker did not advise the fund managers of our subscription. As a result the Aberdeen investment was placed one day late and Standard Life returned the funds at the close of banking on Friday 10 June. The funds were immediately reinvested on the Monday morning with Standard Life and the broker has agreed to reimburse us for the lost interest on both accounts and the additional Chaps fee totalling £174.

The second largest un-invested balance occurred on the 2 June - £355k. Late in the afternoon we received an interim payment from our insurers in relation to claims for storm Desmond. We are advised by the bank that transactions being posted during the day are subject to checking and can be removed, therefore, we do not invest these sums until the following day to limit the risk of being overdrawn.

During the period April to June 2016 there were four instances where the main bank account was overdrawn. Three of these instances related to the amount of £31.18 which was overdrawn over the weekend. The largest and final overdrawn balance occurred on the 30 June for the amount of £431.94. This was as a result of £755.13 of bank charges of being withdrawn late in the day. The cash flow spreadsheet has now been amended to ensure that the closing balance on the final day of each quarter is high enough to cover an estimate of £800 bank charges. It should be noted that for the purposes of banking and overdraft facilities, all accounts with Nat West are pooled and as a result of balances in other accounts, the Commissioner was not actually overdrawn at any time.

Within the Treasury Management Strategy a target is set to achieve a daily balance of +/- £2k on the Commissioner's main bank account. Whilst the daily treasury management process always calculates the anticipated balance within these limits, daily transactions through the bank of which we are not aware (e.g. banking of cash/cheque receipts) can alter the closing balance for the day. During the months April to June 2016, the balance was within the £2k limit for 69 out of 91 days (76%). This statistic is skewed by our policy to ensure that all cash and cheques are banked on a Friday, as a minimum, more often if large sums are received. If cash is banked it clears our account on the same day and we will be over our £2k limit for three days over the weekend not just the day it is banked. This occurred on one occasion during this quarter, which was over the May bank holiday weekend so accounted for four days.

An estimate of the interest forgone on un-invested balances over £2k during this three month period is £138 (ignoring the lost interest discussed above as this will be reimbursed by the broker).

4.3. Investment Activity

There were no investments placed with banks (category 1 unsecured & 2 secured) or Government (category 3) approved investment counterparties during the months of April to June 2016

There were, however, a number of regular smaller investments made via money market funds (category 5 pooled funds).

The Commissioner sets a limit for "non-specified" investments of over 364 days at the time of investment. The maximum of all investments with outstanding maturities greater than 364 days is set at a limit of £5m for 2016/17. The Commissioner currently has no investments that have an outstanding maturity of greater than 364 days. However, as at 30 June, there was one investment which at the time of investing, were for a period of just over 364 days. The details are set out in the table below:

Borrower	Value £m	Investment Period (Days)	Date Invested	End Date	Period Remaining to maturity (days)	Actual Rate (%)
Lloyds Bank PLC	2.0	366	11/08/2015	11/08/2016	42	1.00%
Total	**2.0**					

4.4. Interest Earned

Interest earned for the period of the report and the average return on investment that it represents is set out in the table below:

Month	Interest Amount (£)	Average Total Investment (£)	Average Return on Investment (%)
April 2016	8,780	20,085,356	0.53%
May 2016	7,662	16,471,203	0.55%
June 2016	6,866	15,620,504	0.53%
	23,308	**17,382,232**	**0.54%**

Total interest earned during April to June 2016 amounted to £23k. A simple pro-rata of this figure would suggest a full year effect of interest in the region of £92k, however, indications are that following Britain's referendum on EU membership interest rates will fall over the summer. The current forecast is that interest receipts for 2016/17 will be £60k. A comparison of this figure against the budget is outlined in the table below:

A comparison of this figure against the budget is outlined in the table below:

	Amount (£000's)
Original Estimate 2016/17	100
Forecast Position June 2016	60
Increase/(Decrease) compared to estimate	**-40**
Increase/(Decrease) as a percentatge	-40%

4.5. Investment Performance

As a performance measure for the quality of investment decisions, the rate achieved on maturing longer term investments of over three months in duration is compared with the average Bank of England base rate over the life of the investment. The table below provides details of the individual performance of investments (of over 3 month's duration at time of investment) for the months April to June 2016:

Borrower	Value £m	Period (Months)	Actual Rate (%)	Average Base Rate (%)
Stirling Council	2	4	0.50%	0.50%
Lancashire County Council	2	12	0.50%	0.50%
Nationwide BS	2	6	0.70%	0.50%
Highland Council	2	3	0.50%	0.50%

The above table illustrates that for the four maturing investments that were for a duration of at least three months, the return was slightly higher or equal to the bank base rate.

5. Compliance with Prudential Indicators

5.1. All treasury related Prudential Indicators for 2016/17, which were set in February 2016 as part of the annual Statement of Treasury Management Strategy, have been complied with. Further details can be found at **Appendix 4**.

6. Implications

6.1. Financial – As detailed in the main body of report above.

6.2. Legal – None

6.3. Risk – The report advises the Commissioner/members about treasury activities. Given the large unsecured sums invested with financial institutions treasury management can be a risky area. Nevertheless, procedures are in place to minimise the risks involved, including limits on the sums to be invested with any single institution and reference to credit ratings are set down in the PCC's treasury strategy and in particular the treasury management practices (TMP1 Treasury Risk Management).

6.4. HR / Equality – None

6.5. I.T – None

6.6. Procurement – None

7. Supplementary information

<u>Attachments</u>

Appendix 1 Recent history and projections of Bank Base Rates

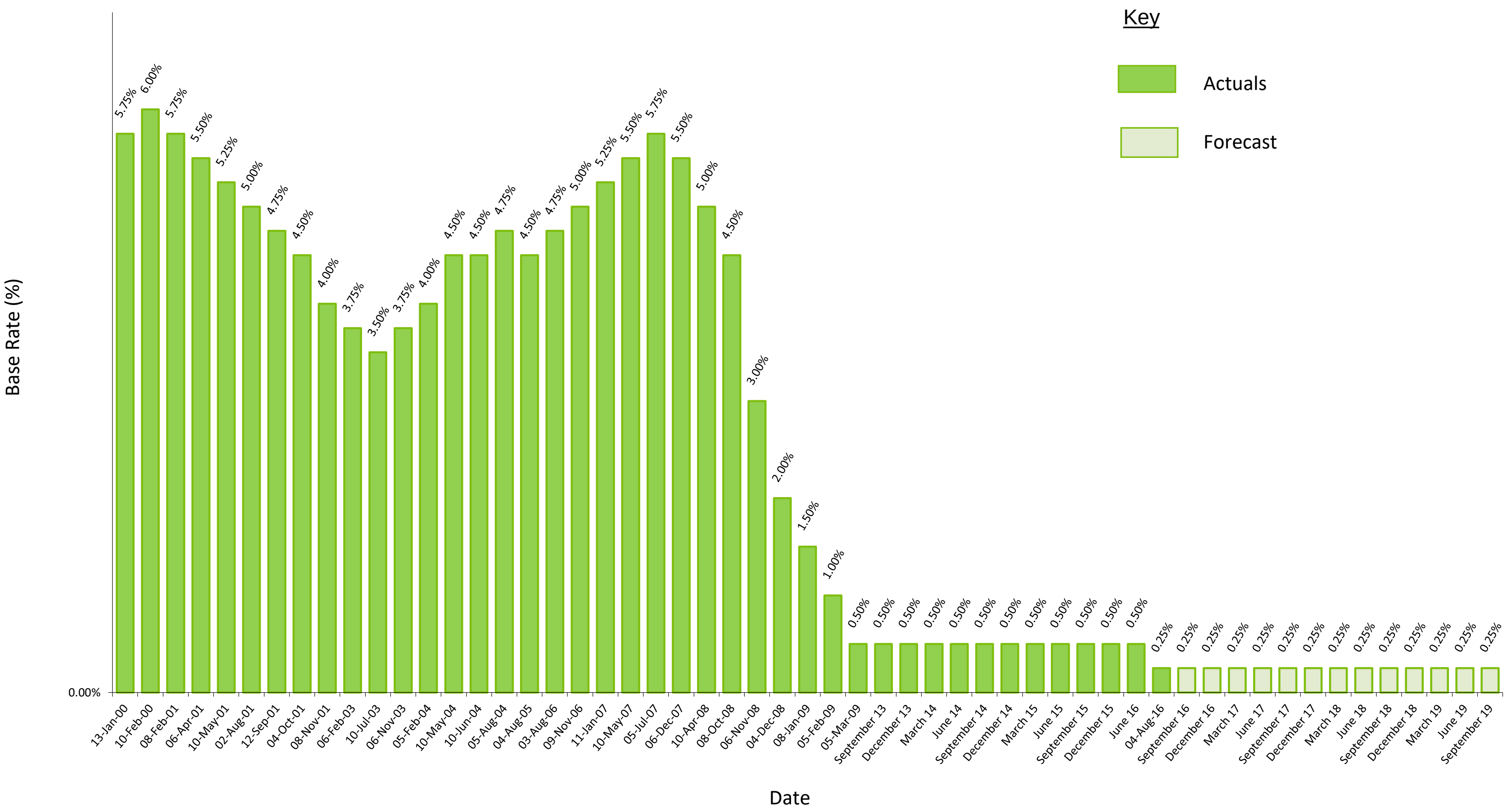
Appendix 2 Schedule of Investments as at 30 June 2016

Appendix 3 Analysis of Investments as at 30 June 2016

Appendix 4 Prudential Indicator Compliance

Appendix 1

Bank of England Base Rates (%s)



Appendix 2

Schedule of Investments as at 30 June 2016

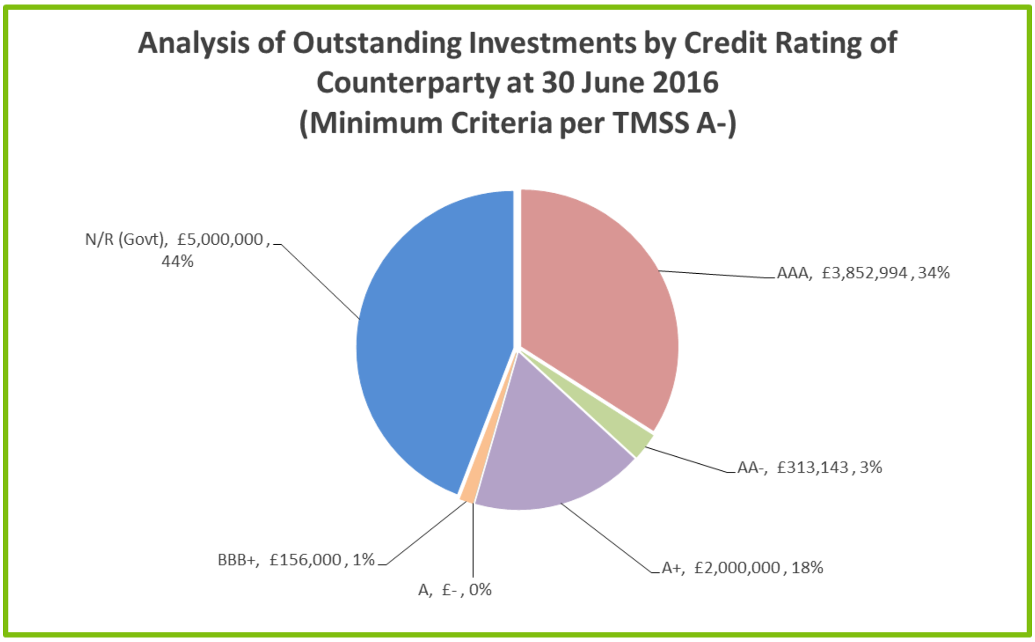
Category/Institution	Credit Rating	Investment Date	Investment Matures	Days to Maturity	Rate (%)	Amount (£)	Counterparty Total (£)
Category 1 - Banks Unsecured (Includes Banks & Building Societies)							
Lloyds Bank Plc	A+	11/08/2015	11/08/2016	42	1.00%	2,000,000	2,000,000
Svenska (Deposit Account)	AA-	Various	On Demand	N/A	0.35%	313,143	313,143
NatWest (Liquidity Select Account)	BBB+	31/03/2016	01/04/2016	O/N	0.25%	156,000	156,000
						2,469,143	2,469,143
Category 2 - Banks Secured (Includes Banks & Building Societies)							
None						0	0
						0	**0**
Category 3 - Government (Includes HM Treasury and Other Local Authorities)							
DMO - DMADF	NR	24/02/2016	23/08/2016	145	0.25%	3,000,000	3,000,000
North Lanarkshire Council	NR	01/03/2016	07/12/2016	160	0.60%	2,000,000	2,000,000
						5,000,000	**5,000,000**
Category 4 -Registered Providers (Includes Providers of Social Housing)							
None						0	0
						0	**0**
Category 5 -Pooled Funds (Includes AAA rated Money Market Funds)							
AIM	AAA	Various	On demand	O/N	0.47%	0	0
BlackRock	AAA	Various	On demand	O/N	0.41%	200,000	200,000
Fidelity	AAA	Various	On demand	O/N	0.43%	302,994	302,994
Goldman Sachs	AAA	Various	On demand	O/N	0.45%	850,000	850,000
Aberdeen Asset Management	AAA	Various	On demand	O/N	0.48%	500,000	500,000
Standard Life (Formally Ignis)	AAA	Various	On demand	O/N	0.51%	2,000,000	2,000,000
						3,852,994	3,852,994
Total						**11,322,138**	**11,322,138**

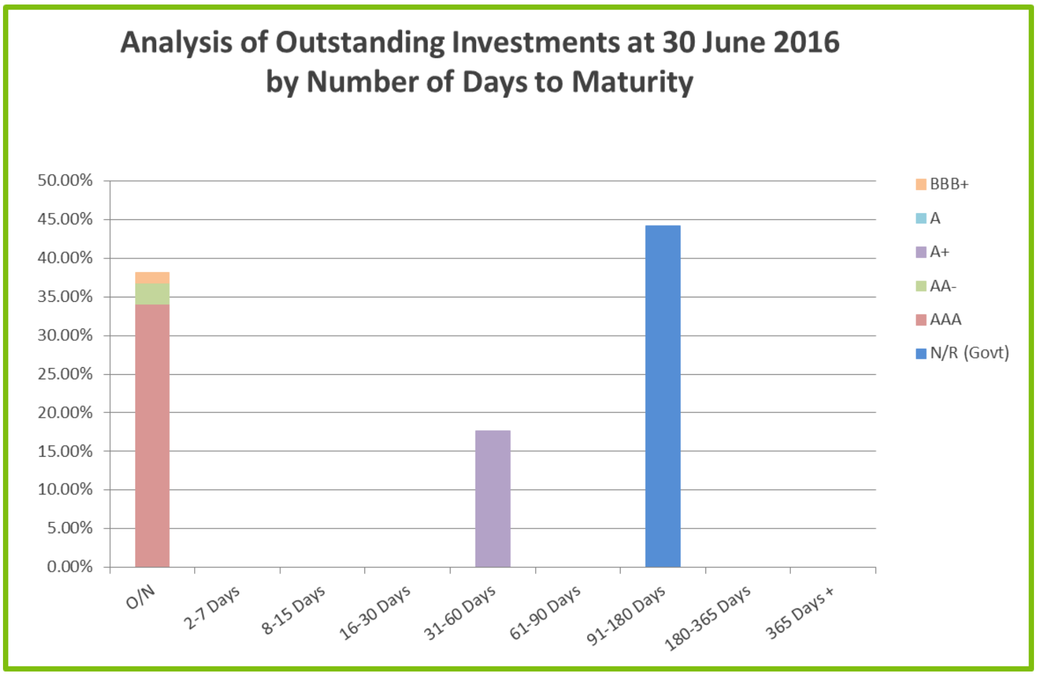
Note – the credit ratings shown in the above table relate to the standing as at 30 June 2016, as discussed in the main body of the report, the ratings are constantly subject to change.

The TMSS sets limits for maximum investment with counterparties. These limits vary depending on the credit rating of the counterparty at the time the investment was placed. The TMSS also places a limit on the total investments per category.

Appendix 3

Analysis of Outstanding Investments as at 30 June 2016





Note – the credit ratings shown in the above charts relate to the standing as at 30 June 2016, as discussed in the main body of the report, the ratings are constantly subject to change.

Appendix 4

Prudential Indicator Compliance

(a) Authorised Limit and Operational Boundary for External Debt

- The Local Government Act 2003 requires the Commissioner to set an Affordable Borrowing Limit, irrespective of their indebted status. This is a statutory limit which should not be breached during the year. The Affordable Borrowing Limit is made up of two components; the *Authorised Limit* and the *Operational Boundary*.
- The Authorised Limit represents an upper limit for external borrowing that could be afforded in the short term but may not be sustainable. The figure includes a risk assessment of exceptional events taking into account the demands of revenue and capital cash flows. The Commissioner's Authorised Limit was set at £24.9m for 2016/17.
- The Operational Boundary is based on the same estimates as the Authorised Limit but reflects the most likely, prudent but not worst case scenario without the additional headroom included within the Authorised Limit. The Operational Boundary for 2016/17 was set at £23.4m.
- The actual amount of external borrowing as at 30 June 2016 was £Nil which is well within the above limits. No new external borrowings have been undertaken in the current financial year.

(b) Upper Limits for Fixed Interest Rate Exposure and Variable Interest Rate Exposure

- These indicators allow the Commissioner to manage the extent to which it is exposed to changes in interest rates.
- The upper limit for variable rate exposure allows for the use of variable rate debt to offset exposure to changes in short-term rates on our portfolio of investments.

	Limits for 2016/17 £m	Actual Borrowing at 30 Jun '16 £m	Compliance with limits
Upper Limit for Fixed Rate Exposure	24.9	0.00	Yes
Upper Limit for Variable Rate Exposure	1.50	0.00	Yes

(c) Maturity Structure of Fixed Rate Borrowing

- This indicator is to limit large concentrations of fixed rate debt needing to be replaced at times of uncertainty over interest rates.

Maturity Structure of Fixed Rate Borrowing	Upper Limit %	Lower Limit %	Actual Fixed Rate Borrowing as at 30 Jun '16 £m	% Fixed Rate Borrowing as at 30 Jun '16 %	Compliance with Set Limits?
Under 12 months	100	0	0.00	0	Yes
12 months and within 24 months	100	0	0.00	0	Yes
24 months and within 5 years	100	0	0.00	0	Yes
5 years and within 10 years	100	0	0.00	0	Yes
10 years and above	100	0	0.00	0	Yes

(d) Total principal sums invested for periods longer than 364 days

- This indicator allows the Commissioner to manage the risk inherent in investments longer than 364 days.
- The limit for 2016/17 was set at £5m.
- As at 30 June 2016, the PCC had one investment totalling £2m which was for a duration greater than 364 days at the time of investment. It no longer has an outstanding maturity greater than 364 days. Please see additional details within paragraph 4.3 above.