Cumbria Office of the Police and Crime Commissioner

Title: Treasury Management Activities 2015/16 Quarter 1 (April to June 2015)

PCC Executive Board: 29 July 2015

Originating Officers: Michelle Bellis, Deputy Chief Finance Officer & 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 2015 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 3 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.

3. Economic Background

3.1. As the quarter progressed, economic data was largely overshadowed by events in Greece. Markets' attention centered on the never-ending Greek issue which stumbled from turmoil to crisis, running the serious risk of a disorderly exit from the Euro. The country's politicians and the representatives of the 'Troika' of its creditors - the European Commission (EC), the European Central Bank (ECB) and the International Monetary Fund (IMF) – barely saw eye to eye. Greece failed to make a scheduled repayment to the IMF on 30th June, in itself not a default until the IMF's Managing Director declares it so. Prime Minister Tsipras blindsided Greece's creditors by calling a referendum on 5th July on reform proposals which by then were off the table anyway. The European Central Bank froze liquidity assistance provided to Greek banks and capital controls within the country severely restricted individuals' and corporates' access to cash.

Greece exiting the euro would not be without fall-out and a detrimental impact on other economies including the UK with the small, but by no means dismissive, risk of contagion into other Eurozone peripheral economies, such as Portugal, Ireland and Spain. After 61% of voters chose to endorse Tsipras' call for a "no" to more austerity, Greece's creditors refused to compromise. A default to the ECB on 20th July could put Greece's membership of the euro in serious doubt, triggering margin calls and putting pressure on the currency bloc as a whole. The situation remains extremely fluid at the time of writing this report.

3.2. UK Economy: The economy remained resilient over the quarter. Although economic growth slowed in Q1 2015 (Q2 data will be released in July) to 0.4%, year/year growth to March 2015 was a relatively healthy 2.9%. GDP has now increased for nine consecutive quarters, breaking a pattern of slow and erratic growth from 2009. The annual rate for consumer price inflation (CPI) briefly turned negative in April, falling to -0.1%, before returning to 0.1%. In the May Quarterly Inflation Report, the Bank of England expected inflation to hover around zero in the near-term as falls in energy and food prices remained in the annual data series for now. The Bank was sanguine that that negative inflation would prove temporary without any damaging consequences for the UK economy. Further improvement in the labour market saw the ILO unemployment rate for March fall to 5.5% of the economically active population. Average earnings excluding bonuses rose 2.2% year/year.

The outcome of the UK general election, largely fought over the parties' approach to dealing with the consequences of the structural deficit and the pace of its removal, saw some very big shifts in the political landscape and put the key issue of the UK's relationship with the EU at the heart of future politics.

3.3. The US economy slowed in the Q1 2015 due to bad weather, spending cuts by the energy firms and the effects of a strong dollar. However as data revisions came through in the latter months of the quarter economic data suggested that growth had re-emerged with retail sales, housing and employment figures all strengthening during the month of May. The decision to increase interest rates in the US became a question of when rather than if; the minutes of the US Federal Reserve's policy meeting showed agreement over interest rate increases by the end of 2015.

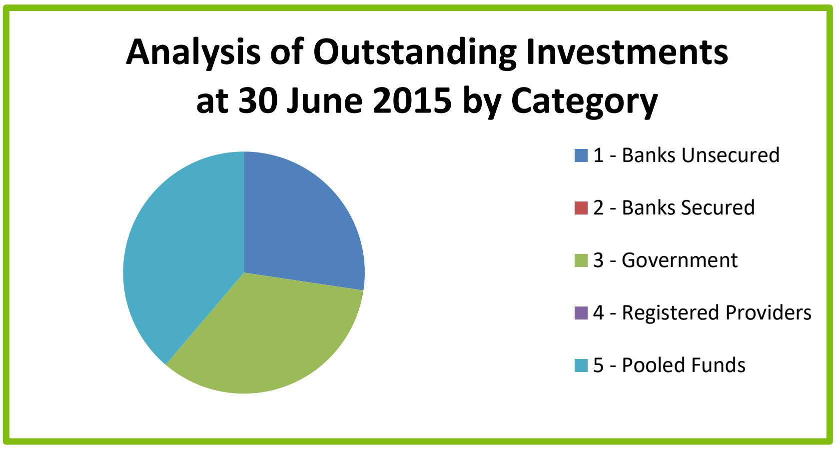
3.4. Market reaction: Equity markets initially reacted positively to the pickup in the expectations of global economic conditions, but were tempered by the breakdown of creditor negotiations in Greece. Government bond markets were quite volatile with yields rising (i.e. prices falling) initially as the risks of deflation seemingly abated. Thereafter yields fell on the outcome of the UK general election and assisted by reappraisal of deflationary factors, before rising again. Bond markets were distorted by the size of the European Central Bank's QE programme, so large that it created illiquidity in the very markets in which it needed to acquire these bonds, notably German government bonds (bunds) where yields were in negative territory. There was a net increase in gilt yields over the quarter. 2-year gilt yields rose by 17bp to 0.56% whilst 3-year yields rose by 25bp to 1.01%. 5- and 10-year gilt yields increased by 35bp and 48bp to 1.51% and 2.02% respectively. 20 year gilt yields saw an increase of 47bp to 2.57%.

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 2015. 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	3.633	Yes
2 - Banks Secured	20	0.000	Yes
3 - Government	unlimited	4.500	Yes
4 - Registered Providers	10	0.000	Yes
5 - Pooled Funds	15	5.152	Yes
Total		**13.285**	



A schedule detailing the individual investments that make up the £13.285m total invested at 30 June 2015 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 2015 for the Commissioner's main bank account are summarised in the table below:

	Number of Days	Average Balance £	Largest Balance £
Days In Credit	90	1,480	9,159
Days Overdrawn	1	(3,342)	(3,342)

The largest un-invested balance occurred on the 30 June and was as a result of a number of cash seizures that were paid into the bank. 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.

The largest overdrawn balance occurred on the 4 June and was the result of a foreign transfer in respect of an invoice payment. The exact timing of when foreign transfers leave the bank is unknown.

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 2015, the balance was within the £2k limit for 72 out of 91 days (79%). 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 3 days over the weekend not just the day it is banked. This occurred on three weekends during this quarter.

An estimate of the interest forgone on un-invested balances over £2k during this three month period is £9.

4.3. Investment Activity

The table below illustrates the number and value of investments made with banks (category 1 unsecured & 2 secured) and Government (category 3) of the approved investment counterparties during the months of April to June 2015:

Month	Number of Investments	Total Value of Investments £m
April 2015	3	4.5
May 2015	1	2.0
June 2015	1	0.5

In addition to the above there are 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 2015/16. The Commissioner currently has no investments that have an outstanding maturity of greater than 364 days. However, as at 30 June, there were two investments which at the time of investing, were for a period of just over 364 days. These are set out in the table below:

Borrower	Value £m	Investment Period (Days)	Date Invested	End Date	Period Remaining to maturity (days)	Actual Rate (%)
Barclays Bank PLC	2.0	365	03/07/2014	03/07/2015	184	0.98%
Lloyds Bank PLC	1.5	365	11/08/2014	11/08/2015	223	0.95%
Total	**3.5**					

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 2015	8,914	21,929,996	0.49%
May 2015	8,916	20,048,849	0.52%
June 2015	7,921	17,652,889	0.53%
Total	**25,750**	**20,073,118**	**0.51%**

Total interest earned during April to June 2015 amounted to £26k. A simple pro-rata of this figure would suggest a full year effect of interest in the region of £103k, however, the interest receipts in the coming months are expected to be a little higher as a result of the receipt of £15m pensions grant in July. The current forecast is that interest receipts for 2015/16 will be on budget at £125k. A comparison of this figure against the budget is outlined in the table below:

	Amount (£000's)
Original Estimate 2015/16	125
Forecast Position June 2015	125
Increase/(Decrease) compared to estimate	**0**
Increase/(Decrease) as a percentatge	0%

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 2015:

Borrower	Value £m	Period (Months)	Actual Rate (%)	Average Base Rate (%)
Lloyds Bank Plc	1.5	12	0.95%	0.50%
Stirling Council	2	6	0.40%	0.50%

The above table illustrates that, for one of the two maturing investments that were for a duration of over 3 months, the return exceeded the bank base rate.

5. Compliance with Prudential Indicators

5.1. All treasury related Prudential Indicators for 2015/16, which were set in February 2015 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

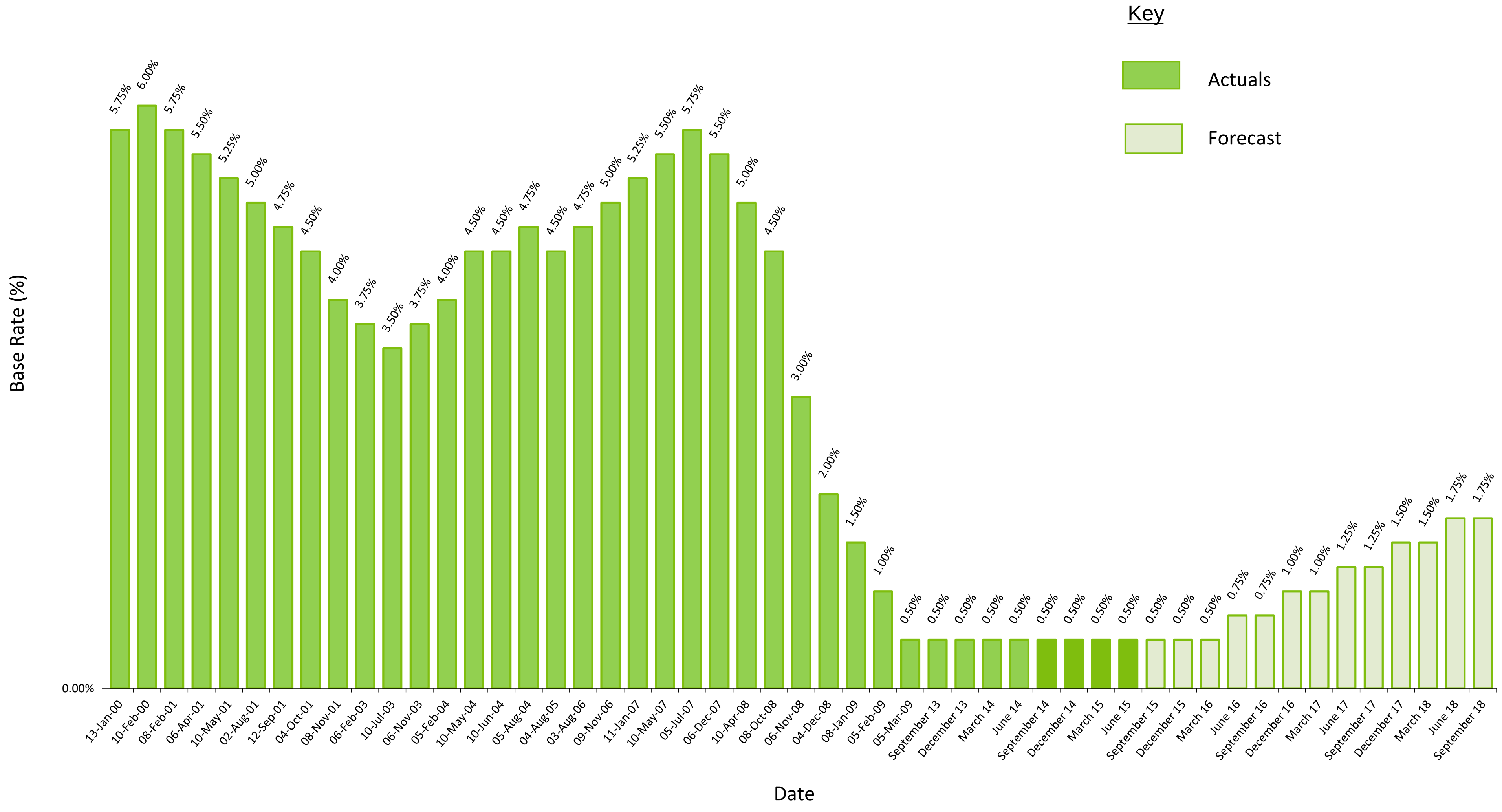
7. Supplementary information

Attachments

Appendix 1	Recent history and projections of Bank Base Rates
Appendix 2	Schedule of Investments as at 30 June 2015
Appendix 3	Analysis of Investments as at 30 June 2015
Appendix 4	Prudential Indicator Compliance

Appendix 1

Bank of England Base Rates (%s)



Appendix 2

Schedule of Investments as at 30 June 2015

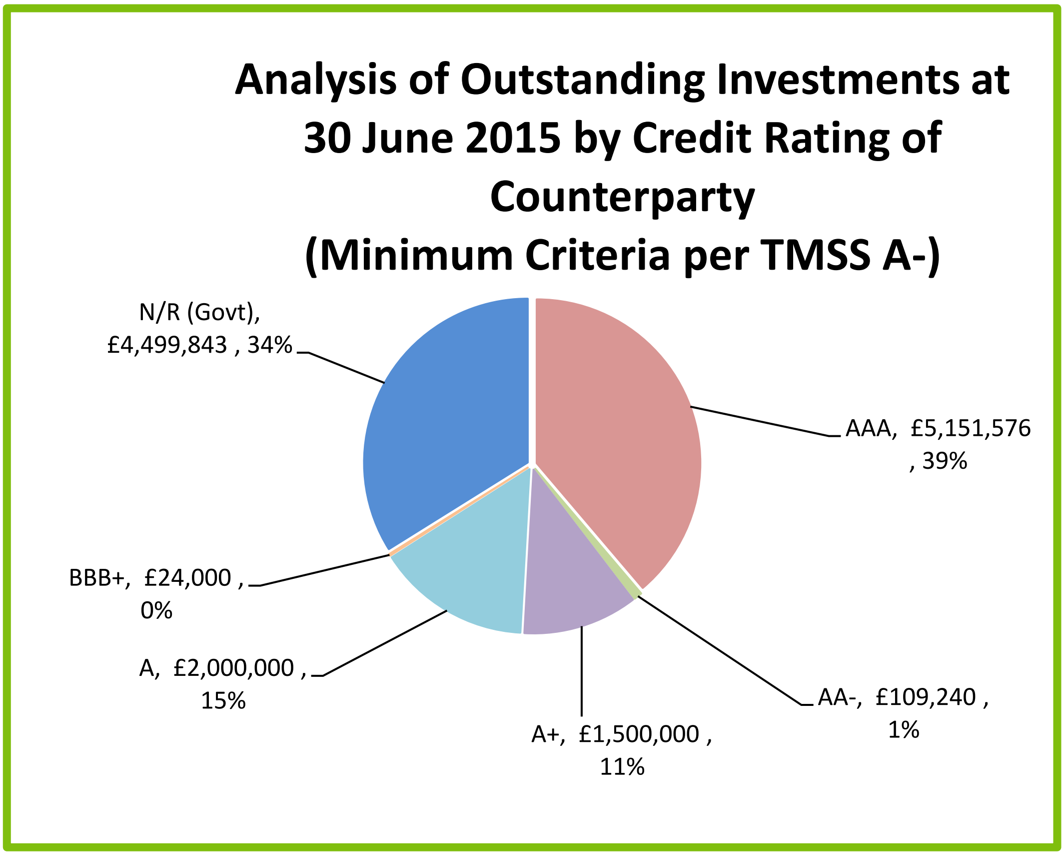
Category/Institution	Credit Rating	Investment Date	Investment Matures	Days to Maturity	Rate (%)	Amount (£)	Counterparty Total (£)
Category 1 - Banks Unsecured (Includes Banks & Building Societies)							
Barclys Bank PLC	A	03/07/2014	03/07/2015	3	0.98%	2,000,000	2,000,000
Lloyds Bank PlC	A+	11/08/2014	11/08/2015	42	0.95%	1,500,000	1,500,000
Svenska Handelsbanken	AA-	Various	On Demand	N/A	0.35%	109,240	109,240
NatWest (Liquidity Select Account)	BBB+	30/06/2015	01/07/2015	O/N	0.25%	24,000	24,000
						3,633,240	3,633,240
Category 2 - Banks Secured (Includes Banks & Building Societies)							
None							0
						0	**0**
Category 3 - Government (Includes HM Treasury and Other Local Authorities)							
Dumfries and Galloway Council	NR	23/04/2015	23/07/2015	23	0.35%	2,000,000	2,000,000
Lancashire County Council	NR	08/05/2015	06/05/2016	311	0.40%	2,000,000	2,000,000
Debt Management Office - Treasury Bills	NR	22/06/2015	20/07/2015	20	0.410%	499,843	499,843
						4,499,843	**4,499,843**
Category 4 -Registered Providers (Includes Providers of Social Housing)							
None							0
						0	**0**
Category 5 -Pooled Funds (Includes AAA rated Money Market Funds)							
Aberdeen Asset Management	AAA	Various	On demand	O/N	Various	200,000	200,000
AIM	AAA	Various	On demand	O/N	Various	400,000	400,000
BlackRock	AAA	Various	On demand	O/N	Various	750,000	750,000
Fidelity	AAA	Various	On demand	O/N	Various	701,576	701,576
Goldman Sachs	AAA	Various	On demand	O/N	Various	600,000	600,000
IGNIS	AAA	Various	On demand	O/N	Various	2,500,000	2,500,000
						5,151,576	5,151,576
Total						**13,284,658**	**13,284,658**

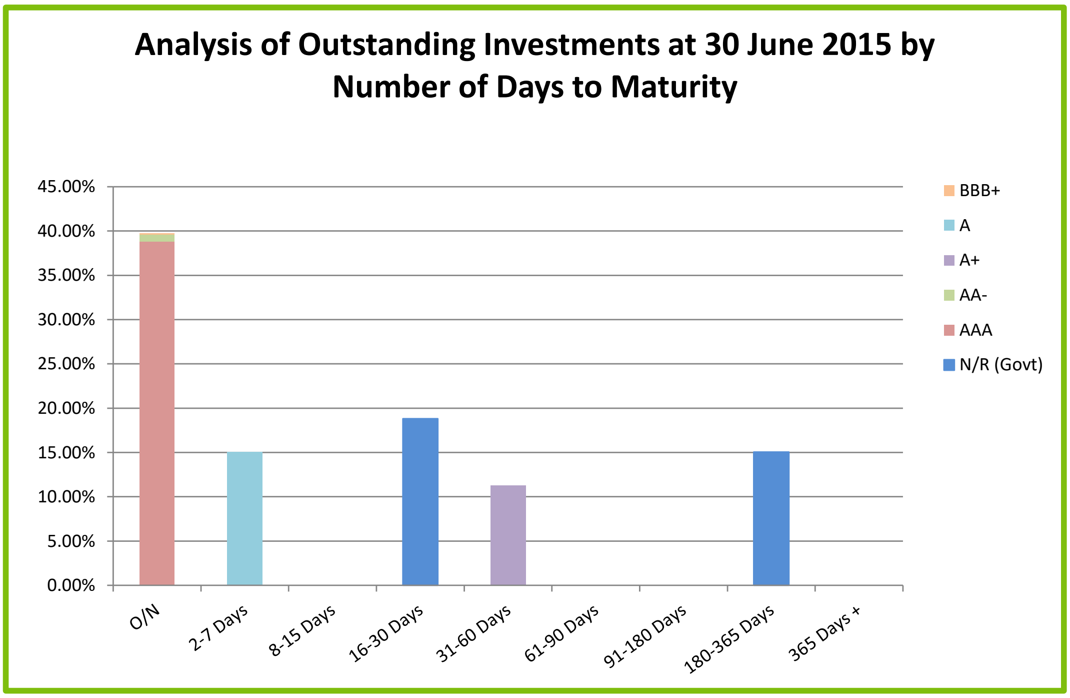
Note – the credit ratings shown in the above table relate to the standing as at 30 June 2015, as discussed in the main body of the report, the ratings are constantly subject to change.

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 2015





Note – the credit ratings shown in the above charts relate to the standing as at 30 June 2015, 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 £25.31m for 2015/16.
- 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 2015/16 was set at £23.81m.
- The actual amount of external borrowing as at 30 June 2015 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 2015/16 £m	Actual Borrowing at 30 Jun'15 £m	Compliance with limits
Upper Limit for Fixed Rate Exposure	25.31	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 '15 £m	% Fixed Rate Borrowing as at 30 Jun '15 %	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 2015/16 was set at £5m.
- As at 30 June 2015, the PCC had two investments totalling £3.5m which were for a duration greater than 364 days at the time of investment. Neither of which now have outstanding maturities greater than 364 days. Please see additional details within paragraph 4.3 above.