Cumbria Office of the Police and Crime Commissioner

Title: Treasury Management Activities 2015/16 Quarter 2 (July to September 2015)

PCC Executive Board: 04 November 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 July to September 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 8 December 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 year began, economic data was largely overshadowed by events in Greece. Markets' attention centered on the never-ending Greek issue stumbled from turmoil to crisis, running the serious risk of a disorderly exit from the Euro. On 12th July, following a weekend European Union Summit, it was announced that the terms for a third bailout of Greece had been reached. The deal amounting to €86 billion was agreed under the terms that Greece would see tax increases, pension reforms and privatisations. A new coalition government must now continue with the unenviable task of guiding Greece through the continuing economic crisis – the Greek saga is far from over.

The summer also saw attention shift towards China as the Shanghai composite index (representing China's main stock market), which had risen a staggering 50%+ since the beginning of 2015, dropped by 43% in less than three months with a reported $3.2 trillion loss to investors, on the back of concerns over growth and after regulators clamped down on margin lending activity in an effort to stop investors 'borrowing to invest' and feeding the stock market bubble. Chinese authorities intensified their intervention in the markets by halting trading in many stocks in an attempt to maintain market confidence. They surprised global markets in August as the People's Bank of China changed the way the yuan is fixed each day against the US dollar and allowed an aggressive devaluation of the currency. This sent jitters through Asian, European and US markets impacting currencies, equities, commodities, oil and metals. On 24th August, Chinese stocks suffered their steepest one-day fall on record, driving down other equity markets around the world and soon becoming known as another 'Black Monday'. Chinese stocks have recovered marginally since and are trading around the same level as the start of the year. Concerns remain about slowing growth and potential deflationary effects.

3.2. UK Economy: The economy has remained resilient over the last six months. Although economic growth slowed in Q1 2015 to 0.4%, year/year growth to March 2015 was a relatively healthy 2.7%. Q2 2015 GDP growth bounced back and was confirmed at 0.7%, with year/year growth showing slight signs of slowing, decreasing to 2.4%. GDP has now increased for ten 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 fluctuating between 0.0% and 0.1% over the next few months. In the August Quarterly Inflation Report, the Bank of England projected that GDP growth will continue around its average rate since 2013. The Bank of England's projections for inflation remained largely unchanged from the May report with them expecting inflation to gradually increase to around 2% over the next 18 months and then remain there in the near future.

3.3. 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. China led stock market turmoil around the globe in August, with the FTSE 100 falling by around 8% overnight on 'Black Monday'. Indices have not recovered to their previous levels but some improvement has been seen. 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. Concerns around China saw bond yields dropping again through August and September. Bond markets were also 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.

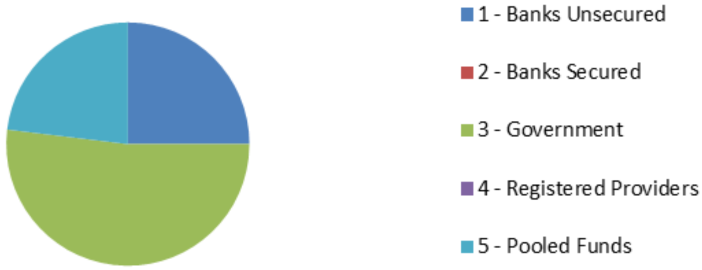
4. Treasury Management Operations and Performance Measures

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 September 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 September (£m)	Compliance with Limit
1 - Banks Unsecured	20	6.005	Yes
2 - Banks Secured	20	0.000	Yes
3 - Government	unlimited	12.482	Yes
4 - Registered Providers	10	0.000	Yes
5 - Pooled Funds	15	5.552	Yes
Total		**24.040**	

Analysis of Outstanding Investments at 30 September 2015 by Category



A schedule detailing the individual investments that make up the £20.040m total invested at 30 September 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 July to September 2015 for the Commissioner's main bank account are summarised in the table below:

	Number of Days	Average Balance £	Largest Balance £
Days In Credit	91	1,522	26,317
Days Overdrawn	1	(2)	(2)

The largest un-invested balance occurred on the 20 August as a result of an overseas pensions transfer being returned to our account as it could no longer be accepted by the overseas scheme. 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 3 September and was the result of a foreign transfer in respect of an invoice payment (£800.15). 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 July to September 2015, the balance was within the £2k limit for 76 out of 92 days (83%). 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 £13.

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 July to September 2015:

Month	Number of Investments	Total Value of Investments £m
July 2015	9	17.5
August 2015	2	3.0
September 2015	1	1.0

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 September, 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 (%)
Lloyds Bank PLC	2.0	366	11/08/2015	11/08/2016	316	1.00%
Lancashire County Council	2.0	365	08/05/2015	06/05/2016	219	0.50%
Total	**4.0**					

4.4. <u>Interest Earned</u>

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 (%)
July 2015	12,046	31,241,856	0.45%
August 2015	12,335	30,444,174	0.48%
September 2015	11,687	28,786,752	0.49%
	36,068	**30,172,494**	**0.47%**

Total interest earned during April to September 2015 amounted to £61.8k. A simple pro-rata of this figure would suggest a full year effect of interest in the region of £124k. The current forecast is that interest receipts for 2015/16 will be £122k. This figure is slightly lower than the budget for the year which was set at £125k, the reduction reflects the lower rates currently being achieved on investments as a result of their short duration, which is in line with current policy and advice.

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
Forecast Position September 2015	122
Increase/(Decrease) compared to estimate	**-3**
Increase/(Decrease) as a percentatge	-2%

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 July to September 2015:

Borrower	Value £m	Period (Months)	Actual Rate (%)	Average Base Rate (%)
Barclays Bank PLC	2	12	0.98%	0.50%
Lloyds Bank PLC	1.5	12	0.95%	0.50%
Dumfries and Galloway	2	3	0.35%	0.50%

The above table illustrates that, for two of the three 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 September 2015

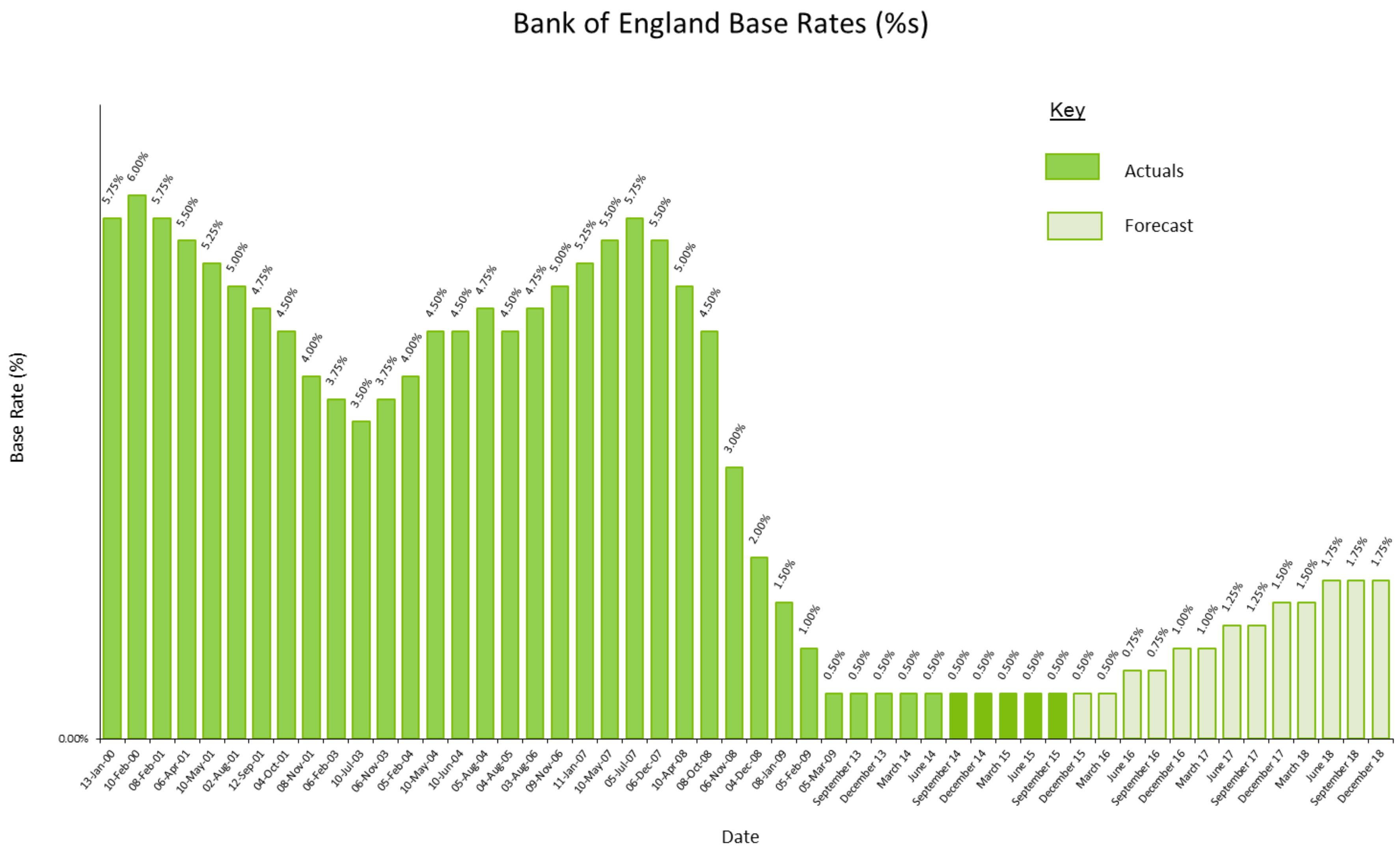
Appendix 3 Analysis of Investments as at 30 September 2015

Appendix 4 Prudential Indicator Compliance

NOT PROTECTIVELY MARKED

PCC 04-11-15 TM Activities 2015-16 Quarter 2 (July to Sep 2015)

Appendix 1



Appendix 2

Schedule of Investments as at 30 September 2015

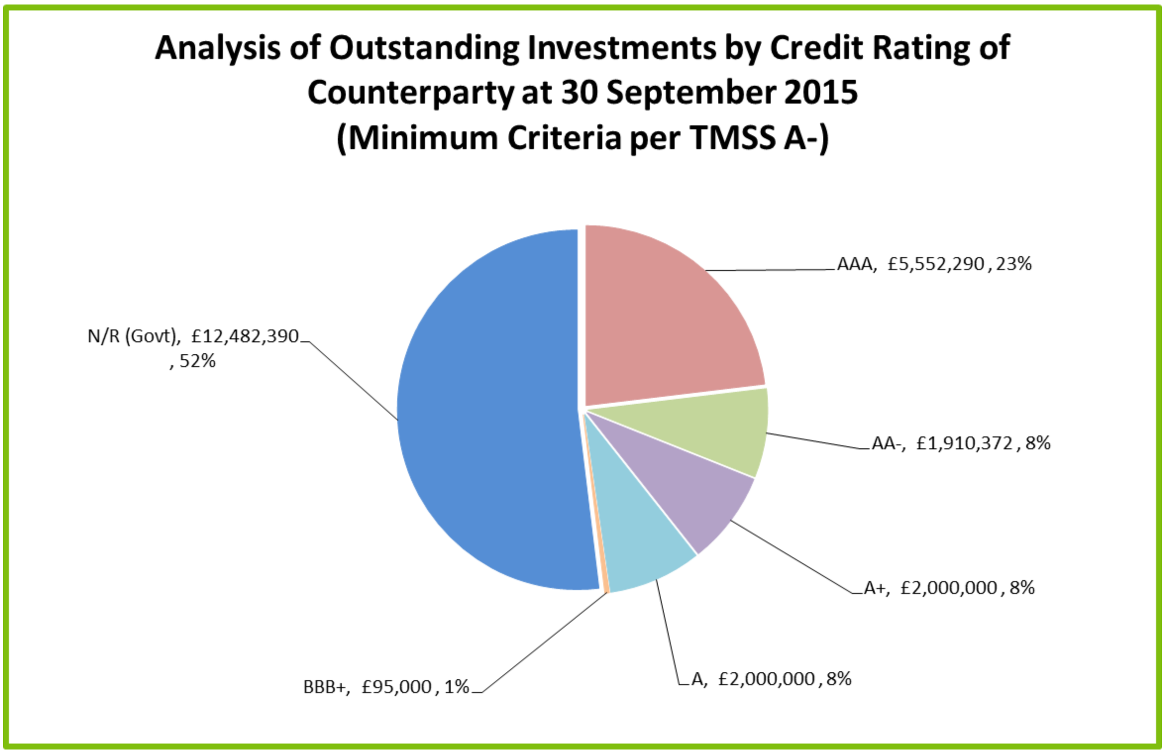
Category/Institution	Credit Rating	Investment Date	Investment Matures	Days to Maturity	Rate (%)	Amount (£)	Counterparty Total (£)
Category 1 - Banks Unsecured (Includes Banks & Building Societies)							
LEEDS	A	03/07/2015	05/10/2015	5	0.41%	2,000,000	2,000,000
LLOYDS BANK PLC	A+	11/08/2015	11/08/2016	316	1.00%	2,000,000	2,000,000
Svenska	AA-	Various	On Demand	N/A	0.35%	1,910,372	1,910,372
NatWest (Liquidity Select Account)	BBB+	30/06/2015	01/07/2015	O/N	0.25%	95,000	95,000
						6,005,372	6,005,372
Category 2 - Banks Secured (Includes Banks & Building Societies)							
None							0
						0	**0**
Category 3 - Government (Includes HM Treasury and Other Local Authorities)							
West Dunbartonshire Council	NR	24/07/2015	22/01/2016	114	0.40%	2,000,000	2,000,000
Lancashire County Council	NR	08/05/2015	06/05/2016	219	0.50%	2,000,000	2,000,000
DMO - Treasury Bills	NR	06/07/2015	05/10/2015	5	0.470%	1,997,659	
DMO - Treasury Bills	NR	20/07/2015	19/10/2015	19	0.450%	499,440	
DMO - Treasury Bills	NR	06/07/2015	04/01/2016	96	0.490%	4,987,813	
DMO - Treasury Bills	NR	01/09/2015	29/02/2016	152	0.510%	997,477	8,482,390
						12,482,390	**12,482,390**
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	1,300,000	1,300,000
AIM	AAA	Various	On demand	O/N	Various	0	0
BlackRock	AAA	Various	On demand	O/N	Various	0	0
Fidelity	AAA	Various	On demand	O/N	Various	352,290	352,290
Goldman Sachs	AAA	Various	On demand	O/N	Various	1,400,000	1,400,000
Standard Life (Formally Ignis)	AAA	Various	On demand	O/N	Various	2,500,000	2,500,000
						5,552,290	5,552,290
Total						**24,040,052**	**24,040,052**

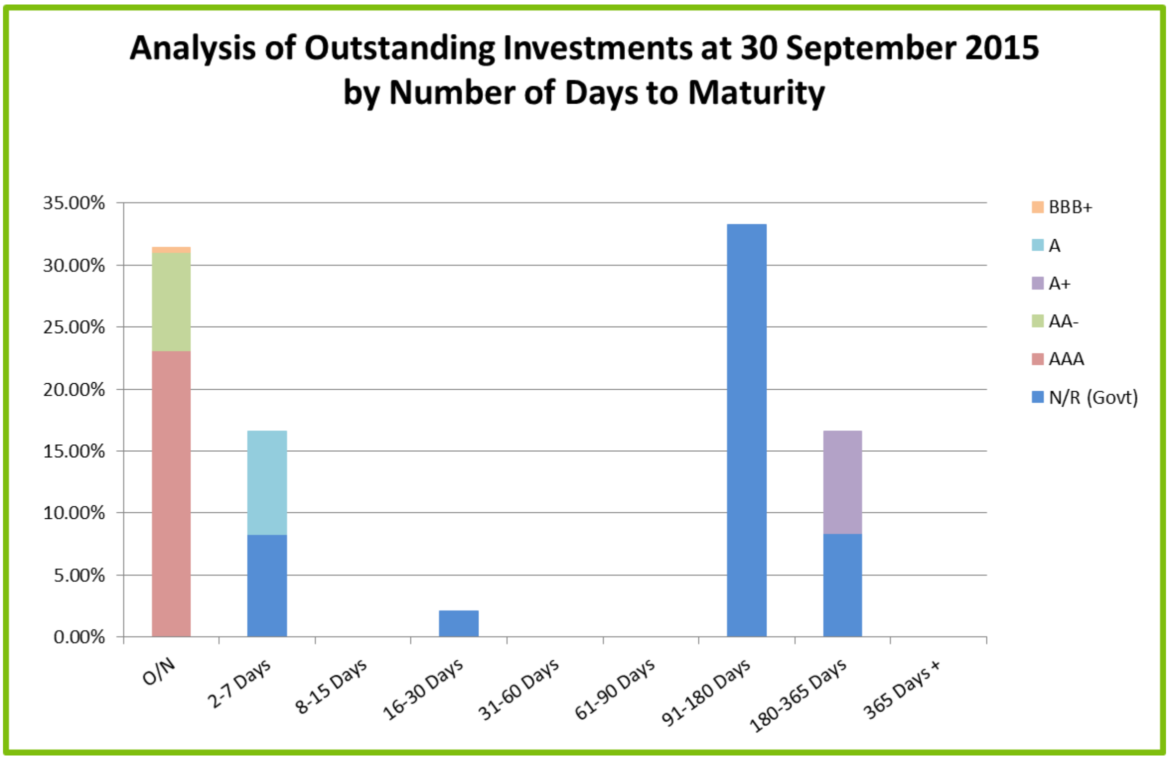
Note – the credit ratings shown in the above table relate to the standing as at 30 September 2015, as discussed in the main body of the report, the ratings are constantly subject to change.

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 September 2015





Note – the credit ratings shown in the above charts relate to the standing as at 30 September 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 September 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 Sep'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 Sep '15 £m	% Fixed Rate Borrowing as at 30 Sep '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 September 2015, the PCC had two investments totalling £4.0m 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.