Cumbria Office of the Police and Crime Commissioner

Title: Treasury Management Activities 2015/16 Quarter 3 (October to December 2015)

PCC Executive Board: 24 February 2016

Joint Audit & Standards Committee: 09 March 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 October to December 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 9 March 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 was presented to the Commissioner at his Executive Board meeting on 16 February.

3. Economic Background

3.1. The UK economy had a solid 2015 with overall growth estimated to be around 2.5%, a figure well in line with the trend rate. The labour market was also strong. Data released in December for the period to October 2015, showed employment the highest at 73.9% and unemployment at 5.2% the lowest it had been since 2006. As a result, wage growth was generally strong over the year; although having peaked at 3.3% in May, it fell to 2.4% in October. Consumer price inflation was very low over the second half of 2015, a collapse in food, fuel and transport costs along with a strong Pound being the contributors to this fall. Stronger wage growth and low inflation allowed real earnings to grow at the fastest rate in eight years. At the beginning of the October-December 2015 quarter the general consensus was that the MPC would look to raise interest rates in early 2016. However a number of factors have pushed back the expectation of a rate rise to Q3 or Q4 of 2016, with possibly one or two increases in 2017: inflation, having dipped below zero earlier in 2015, remained very low at 0.1% year/year in November 2015, oil prices have fallen even further and growth in China isn't looking like it is going to return to its usual 7%+ levels very soon.

3.2. In the US, the Federal Reserve raised interest rates in December 2015 for the first time in nine years to take the new Federal funds range to 0.25%-0.50%. The accompanying statement justified this increase as due to continuing tightening of the labour market, the solid improvement in economic household spending and business fixed investment and a strong housing sector. The statement suggested we can expect four interest rises over 2016. Over 2015, the US dollar appreciated by 8%, leading to lower import prices. The decline in import prices filtered into consumer prices in 2015, which alongside the sharp drop in energy costs, depressed the headline inflation rate. However, as a result of the strong dollar and weak global demand, US exports have fallen by nearly 10% over the year. With the presidential elections coming up at the end the year, we should start to see uncertainty creep into the market until a clear winner emerges.

3.3. In the Eurozone, the European Central Bank announced a modest reduction in the Deposit Rate from -0.2% to -0.3% and an extension of their asset purchase programme by 6 months to March 2017.

Overall, the Eurozone economic activity was stronger over 2015 and there was an improvement in unemployment to 10.5% from 11.5% a year earlier, which helped drive private consumption as a result. Eurozone CPI inflation fell below zero during 2015 and is currently hovering just above.

3.4. The slowdown in the Chinese economy became the largest threat to the region and to the prospects for global growth as a whole. The effect of the Chinese authorities' intervention in their currency and equity markets was temporary and led to further market volatility as a consequence. As the global economy entered 2016, there was a high uncertainty about growth, the outcome of the US presidential election (no clear party or candidate can be identified as a winner right now) and the consequences of the vote whether the UK is to remain in the EU, the timing of which could well likely be summer 2016.

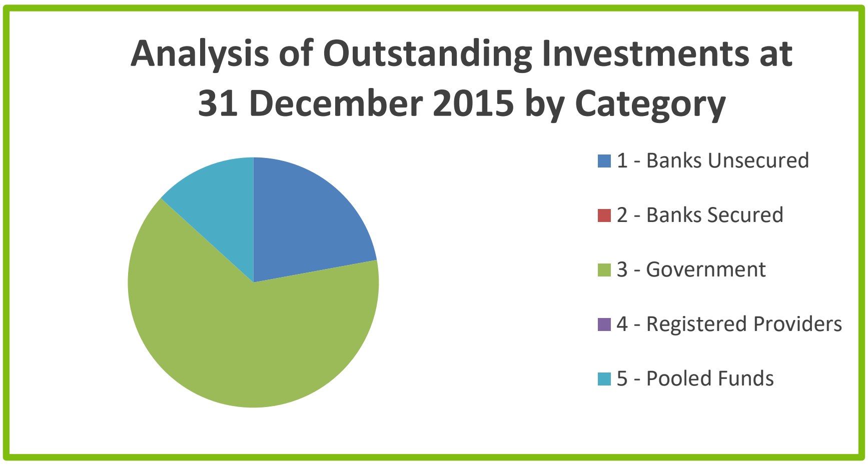
4. Treasury Management Operations and Performance Measures

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 31 December 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 31 December (£m)	Compliance with Limit
1 - Banks Unsecured	20	4.269	Yes
2 - Banks Secured	20	0.000	Yes
3 - Government	unlimited	12.485	Yes
4 - Registered Providers	10	0.000	Yes
5 - Pooled Funds	15	2.553	Yes
Total		**19.306**	

A schedule detailing the individual investments that make up the £19.31m total invested at 31 December 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. <u>Management of Cash Balances</u>

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 October to December 2015 for the Commissioner's main bank account are summarised in the table below:

	Number of Days	Average Balance £	Largest Balance £
Days In Credit	92	1,174	13,155
Days Overdrawn	0	0	0

The largest un-invested balance occurred on the 3 December as a result of a large banking of seized cash. 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 October to December 2015 there were no instances where the main bank account was overdrawn.

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 October to December 2015, the balance was within the £2k limit for 82 out of 92 days (89%). 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 did not occur during this quarter.

An estimate of the interest forgone on un-invested balances over £2k during this three month period is £4.

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 October to December 2015:

Month	Number of Investments	Total Value of Investments £m
October 2015	4	5.5
November 2015	1	1.0
December 2015	1	2.0

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 31 December, 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. 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 (%)
October 2015	11,197	26,580,591	0.50%
November 2015	10,467	25,104,230	0.51%
December 2015	10,253	23,090,361	0.52%
	31,917	**24,923,113**	**0.51%**

Total interest earned during April to December 2015 amounted to £93.7k. A simple pro-rata of this figure would suggest a full year effect of interest in the region of £125k. The current forecast is that interest receipts for 2015/16 will be £117k. 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
Forecast Position Decemner 2015	117
Increase/(Decrease) compared to estimate	**-8**
Increase/(Decrease) as a percentatge	-6%

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 October to December 2015:

Borrower	Value £m	Period (Months)	Actual Rate (%)	Average Base Rate (%)
Barclays Bank PLC	2	3	0.41%	0.50%
Government Treasury Bill	2	3	0.47%	0.50%
Government Treasury Bill	0.5	3	0.45%	0.50%

The above table illustrates that for the three maturing investments that were for a duration of 3 months, the return was slightly below 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

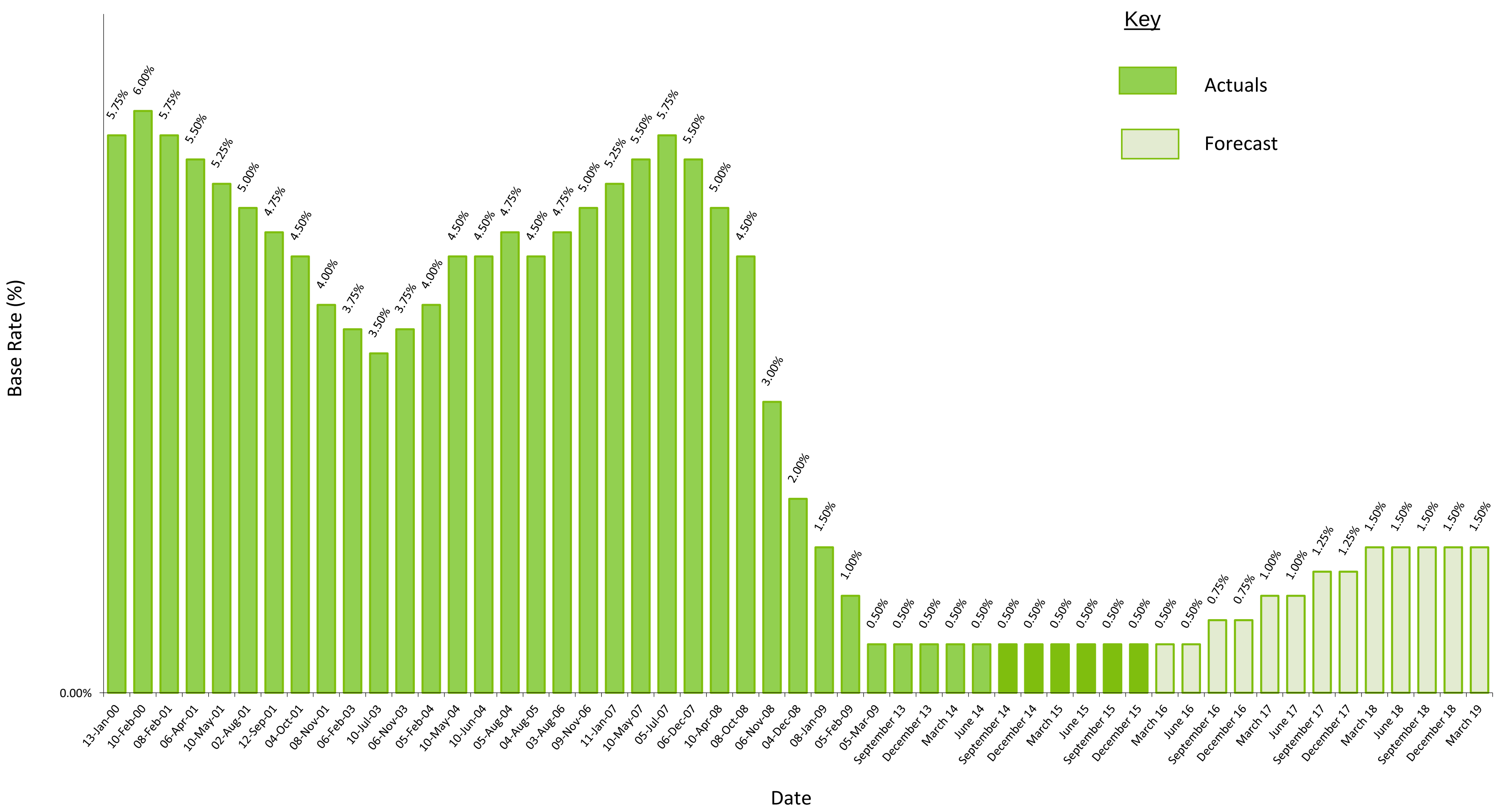
7. Supplementary information

<u>Attachments</u>

Appendix 1	Recent history and projections of Bank Base Rates
Appendix 2	Schedule of Investments as at 31 December 2015
Appendix 3	Analysis of Investments as at 31 December 2015
Appendix 4	Prudential Indicator Compliance

Appendix 1

Bank of England Base Rates (%s)



Appendix 2

Schedule of Investments as at 31 December 2015

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	224	1.00%	2,000,000	2,000,000
Svenska (Deposit Account)	AA-	Various	On Demand	N/A	0.35%	911,732	911,732
NatWest (Liquidity Select Account)	BBB+	31/12/2015	04/01/2016	O/N	0.25%	357,000	357,000
Svenska (CD*)	AA-	03/11/2015	03/02/2016	34	0.54%	1,000,000	1,000,000
						4,268,732	4,268,732
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	22	0.40%	2,000,000	2,000,000
Lancashire County Council	NR	08/05/2015	06/05/2016	127	0.50%	2,000,000	2,000,000
Stirling Council	NR	14/12/2015	14/04/2016	105	0.500%	2,000,000	2,000,000
DMO - Treasury Bills	NR	06/07/2015	04/01/2016	4	0.490%	4,987,813	
DMO - Treasury Bills	NR	19/10/2015	18/01/2016	18	0.450%	499,427	
DMO - Treasury Bills	NR	01/09/2015	29/02/2016	60	0.510%	997,477	6,484,718
						12,484,718	**12,484,718**
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	0	0
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	252,685	252,685
Goldman Sachs	AAA	Various	On demand	O/N	Various	0	0
Standard Life (Formally Ignis)	AAA	Various	On demand	O/N	Various	2,300,000	2,300,000
						2,552,685	2,552,685
Total						**19,306,135**	**19,306,135**

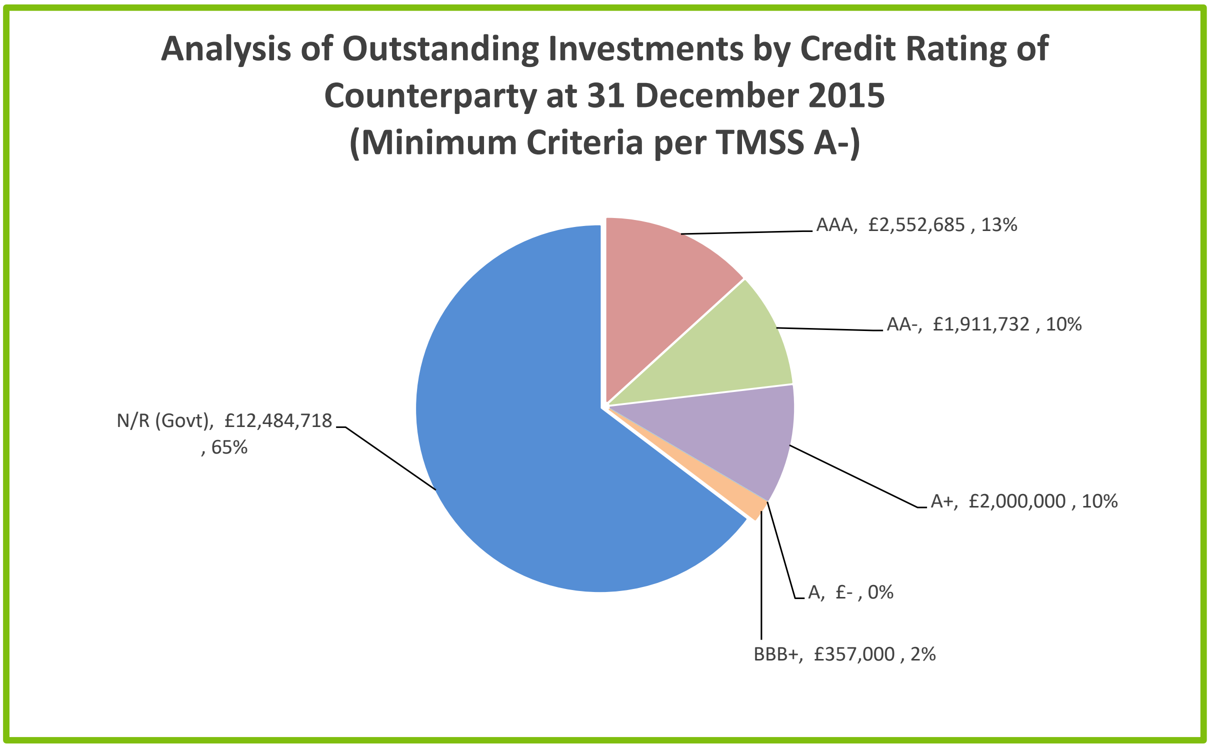
Note – the credit ratings shown in the above table relate to the standing as at 31 December 2015, as discussed in the main body of the report, the ratings are constantly subject to change.

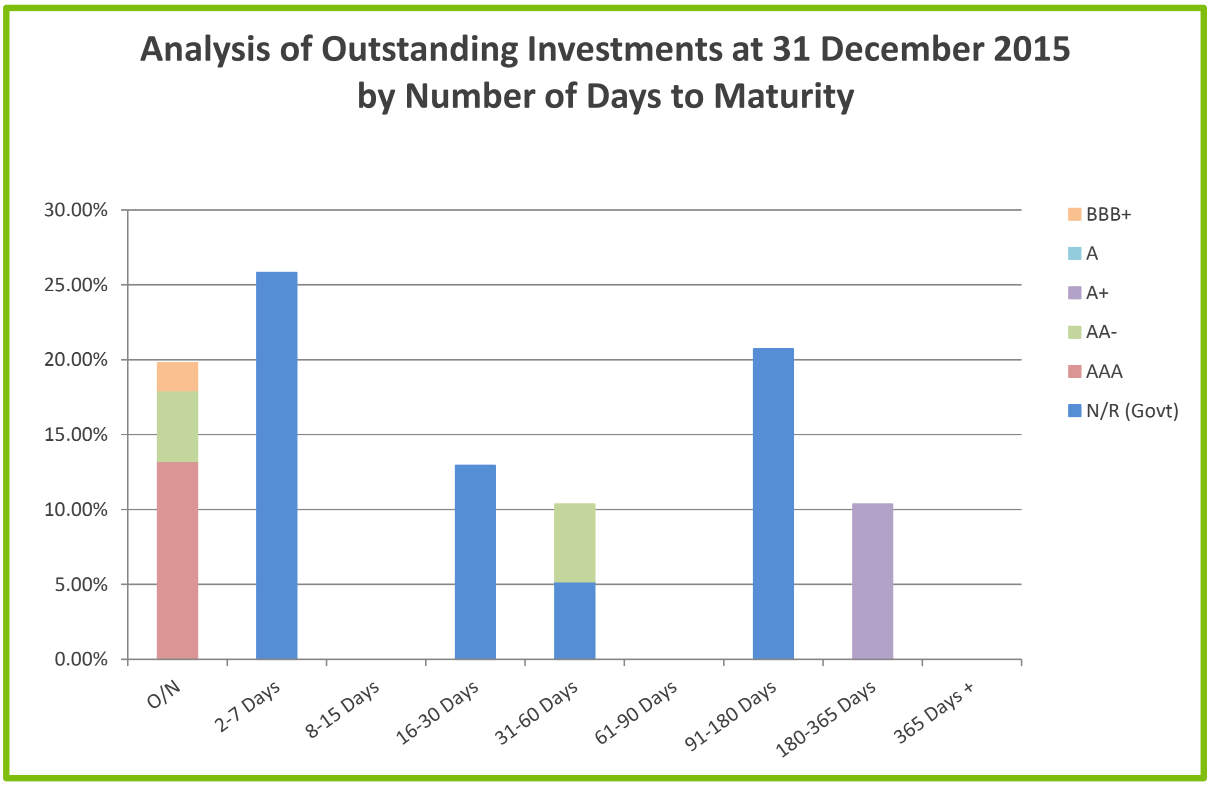
The TMSS sets limits for maximum investment with counterparties. These limits vary depending on the credit rating of the counterparty at the time the investment was placed. The TMSS also places a limit on the total investments per category.

CD* = Certificate of Deposit which are a negotiable form of fixed deposit and are ranked the same as a fixed deposit. The primary difference is that we are not obliged to hold the CD to maturity and cash can be realised by selling the CD on the secondary market.

Appendix 3

Analysis of Outstanding Investments as at 31 December 2015





Note – the credit ratings shown in the above charts relate to the standing as at 31 December 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 31 December 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 31 Dec'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 31 Dec '15 £m	% Fixed Rate Borrowing as at 31 Dec '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 31 December 2015, the PCC had two investments totalling £4m 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.