Cumbria Office of the Police and Crime Commissioner

Title: Treasury Management Activities 2015/16 Quarter 4 (January to March 2016)

PCC Decision Meeting: 3 May 2016

Joint Audit & Standards Committee: 3 May 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 January to March 2016 and to provide a brief annual report on the treasury management function for the 2015/16 financial year. Both elements of the report are requirements 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 May 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 his decision meeting on 3 May.

3. Economic Background

3.1. Growth, Inflation, Employment: The UK economy slowed in 2015 with GDP growth falling to 2.3% from a robust 3.0% the year before. CPI inflation hovered around 0.0% through 2015 with deflationary spells in April, September and October. The prolonged spell of low inflation was attributed to the continued collapse in the price of oil from $67 a barrel in May 2015 to just under $28 a barrel in January 2016, the appreciation of sterling since 2013 pushing down import prices and weaker than anticipated wage growth resulting in subdued unit labour costs. CPI picked up to 0.3% year/year in February, but this was still well below the Bank of England's 2% inflation target. The labour market continued to improve through 2015 and in Q1 2016, the latest figures (Jan 2016) showing the employment rate at 74.1% (the highest rate since comparable records began in 1971) and the unemployment rate at a 12 year low of 5.1%. Wage growth has however remained modest at around 2.2% excluding bonuses, but after a long period of negative real wage growth (i.e. after inflation) real earnings were positive and growing at their fastest rate in eight years, boosting consumers' spending power.

3.2. Global influences: The slowdown in the Chinese economy became the largest threat to the South East Asian region, particularly on economies with a large trade dependency on China and also to 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 high market volatility as a consequence. There were falls in prices of equities and risky assets and a widening in corporate credit spreads. As the global economy entered 2016 there was high uncertainty about growth, the outcome of the US presidential election and the consequences of June's referendum on whether the UK is to remain in the EU. Between February and March 2016 sterling had depreciated by around 3%, a significant proportion of the decline reflecting the uncertainty surrounding the referendum result.

3.3. UK Monetary Policy: The Bank of England's MPC (Monetary Policy Committee) made no change to policy, maintaining the Bank Rate at 0.5% (in March it entered its eighth year at 0.5%) and asset purchases (Quantitative Easing) at £375bn. In its Inflation Reports and monthly monetary policy meeting minutes, the Bank was at pains to stress and reiterate that when interest rates do begin to rise they were expected to do so more gradually and to a lower level than in recent cycles.

3.4. Improvement in household spending, business fixed investment, a strong housing sector and solid employment gains in the US allowed the Federal Reserve to raise rates in December 2015 for the first time in nine years to take the new Federal funds range to 0.25%-0.50%. Despite signalling four further rate hikes in 2016, the Fed chose not to increase rates further in Q1 and markets pared back expectations to no more than two further hikes this year. However central bankers in the Eurozone, Switzerland, Sweden and Japan were forced to take policy rates into negative territory. The European Central Bank also announced a range of measures to inject sustained economic recovery and boost domestic inflation which included an increase in asset purchases (Quantitative Easing).

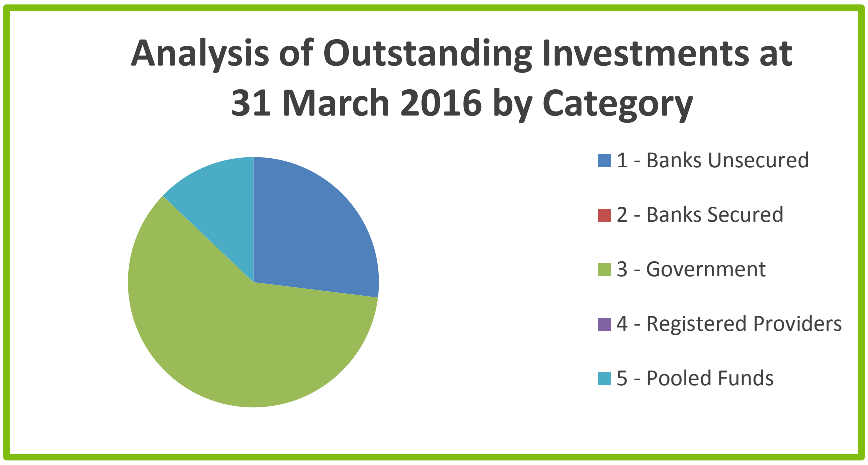
3.5. Market reaction: From June 2015 gilt yields were driven lower by the a weakening in Chinese growth, the knock-on effects of the fall in its stock market, the continuing fall in the price of oil and commodities and acceptance of diminishing effectiveness of central bankers' unconventional policy actions. Added to this was the heightened uncertainty surrounding the outcome of the UK referendum on its continued membership of the EU as well as the US presidential elections which culminated in a significant volatility and in equities and corporate bond yields. 10-year gilt yields moved from 1.58% on 31/03/2015 to a high of 2.19% in June before falling back and ending the financial year at 1.42%. The pattern for 20-year gilts was similar, the yield rose from 2.15% in March 2015 to a high of 2.71% in June before falling back to 2.14% in March 2016. The FTSE All Share Index fell 7.3% from 3664 to 3395 and the MSCI World Index fell 5.3% from 1741 to 1648 over the 12 months to 31 March 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 March 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 31 March (£m)	Compliance with Limit
1 - Banks Unsecured	20	4.928	Yes
2 - Banks Secured	20	0.000	Yes
3 - Government	unlimited	11.000	Yes
4 - Registered Providers	10	0.000	Yes
5 - Pooled Funds	15	2.353	Yes
Total		**18.280**	



A schedule detailing the individual investments that make up the £18.28m total invested at 31 March 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 January to March 2016 for the Commissioner's main bank account are summarised in the table below:

	Number of Days	Average Balance £	Largest Balance £
Days In Credit	91	2,228	30,529
Days Overdrawn	0	0	0

The largest un-invested balance occurred on the 10 March 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 January to March 2016 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 January to March 2016, the balance was within the £2k limit for 58 out of 91 days (64%). 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 6 occasions during this quarter, one of which was over the Easter bank holiday weekend so accounted for 5 days.

An estimate of the interest forgone on un-invested balances over £2k during this three month period is £42.

4.3. <u>Investment Activity</u>

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 January to March 2016:

Month	Number of Investments	Total Value of Investments £m
January 2016	3	5.0
February 2016	2	4.0
March 2016	2	4.0

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 March, 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	133	1.00%
Lancashire County Council	2.0	365	08/05/2015	06/05/2016	36	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 (%)
January 2016	10,060	20,334,423	0.58%
February 2016	9,447	21,744,495	0.55%
March 2016	10,189	23,716,326	0.51%
	29,696	**24,923,113**	**0.54%**

Total interest earned for the period January to March 2016 amounted to £30k bringing the total interest earned during 2015/16 to £123.3k. A comparison of this outturn against the budget and previous forecasts is outlined in the table below. This figure is slightly lower than the budget for the year which was set 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
Forecast Position September 2015	122
Forecast Position December 2015	117
Year end position 31 March 2016	**123**
Increase/(Decrease) compared to estimate	**-2**
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 January to March 2016:

Borrower	Value £m	Period (Months)	Actual Rate (%)	Average Base Rate (%)
Government - Treasury Bill	5	6	0.49%	0.50%
Government - Treasury Bill	0.5	3	0.46%	0.50%
Government - Treasury Bill	1	6	0.51%	0.50%
Svenska - CD	1	3	0.54%	0.50%
West Dunbartonshire Council	2	6	0.40%	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. Annual Report on Treasury Management Operations 2015/16

5.1. Treasury Strategy

In February 2015 the Commissioner approved the 2015/16 Treasury Management Strategy Statement (TMSS). The TMSS incorporated the investment and borrowing strategies for the 2015/16 financial year. The investment strategy approved for 2015/16 was largely the same as had been adopted for the previous year with some changes introducing new classes of investment (for example treasury bills and certificates of deposit) to allow more flexibility and diversification. These limits for each category of investment were based on the relative security of each class of financial institution and a percentage of the estimated balances, which would be available for investment during the year.

5.2. In relation to borrowing, the Commissioner has an underlying need to borrow funds to finance the capital programme, which is measured by the Capital Financing requirement (CFR). The CFR at the start of 2015/16 amounted to £17.04m (including £5.2m relating to the PFI agreement for West Cumbria TPA HQ in Workington) leaving a £11.84m exposure to external borrowing at some time into the future, which is presently being covered by the use of internal funds (reserves).

5.3. During 2015/16 the Commissioner has maintained this strategy of using cash balances, arising primarily from its reserves, to meet its cash flow commitments and was not therefore compelled to borrow. Although long term borrowing rates remained relatively low during 2015/16, a conscious decision was made to defer long term financing decisions as the short term cost of carrying debt (i.e. the differential between the borrowing rate at say 3% and the rate of under 1% available when such funding was invested) would have had an adverse effect on the revenue budget for the year and the immediate outlook period. The Commissioner in consultation with the treasury advisors Arlingclose Ltd continues to look for the most opportune time to undertake any borrowing.

5.4. Key Statistics.

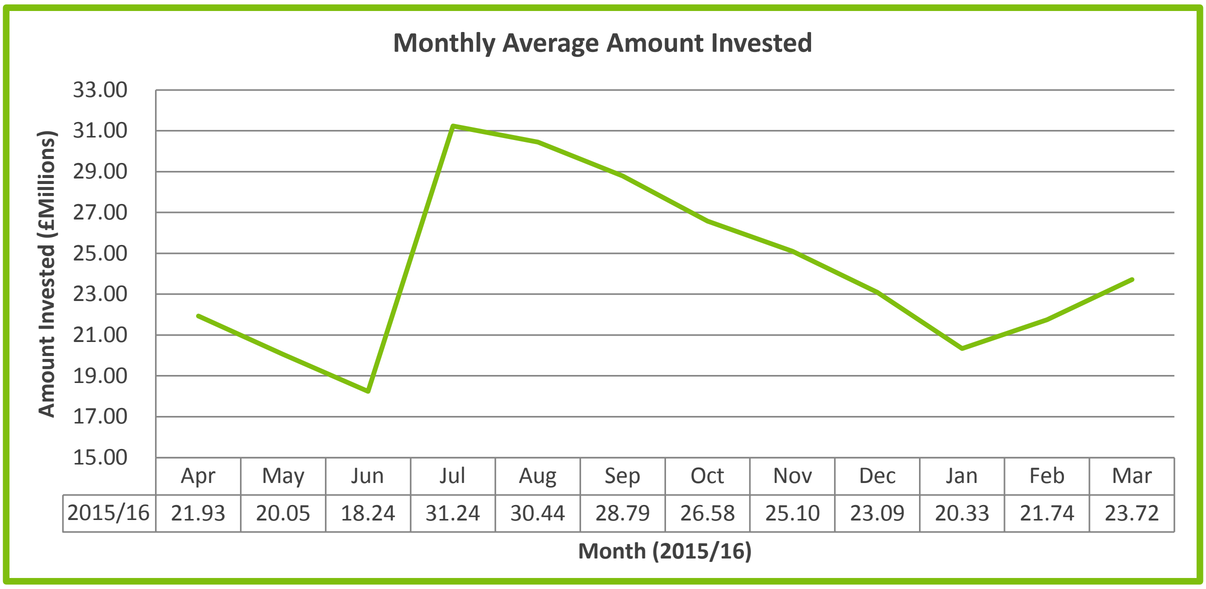
5.4.1. Principal

During 2015/16 a total of 244 investments were placed amounting to £160.21m (2014/15 230 investments amounting to £123.44m).

Counterparty Type	Opening Balance (£m)	Investments (£m)	Maturities (£m)	Closing Balance (£m)	Number of Investments Placed during 2015/16
Banks and Building Socities	7.51	21.31	- 23.90	4.91	21.00
Government (Other LA/Treasury Bills)	7.50	40.48	- 36.98	11.00	17.00
NatWest Overnight	0.05	5.58	- 5.62	0.02	151.00
Money Market Funds	4.30	92.85	- 94.80	2.35	55.00
	19.36	**160.21**	**- 161.30**	**18.28**	**244.00**

Of the above transactions, 93 were to external counterparties and as such will have attracted a £10 transfer fee per transaction. The transfer to the NatWest Liquidity Select account for overnight money is classed as an 'inter-account transfer' as the NatWest holds the Commissioner's main bank account. This type of transfer is free although we do pay a small fee to access the internet banking site. A detailed breakdown of the closing balance invested as at 31 March 2016 is provided at **Appendix 2.**

The chart below illustrates the monthly average of amounts invested during the year.

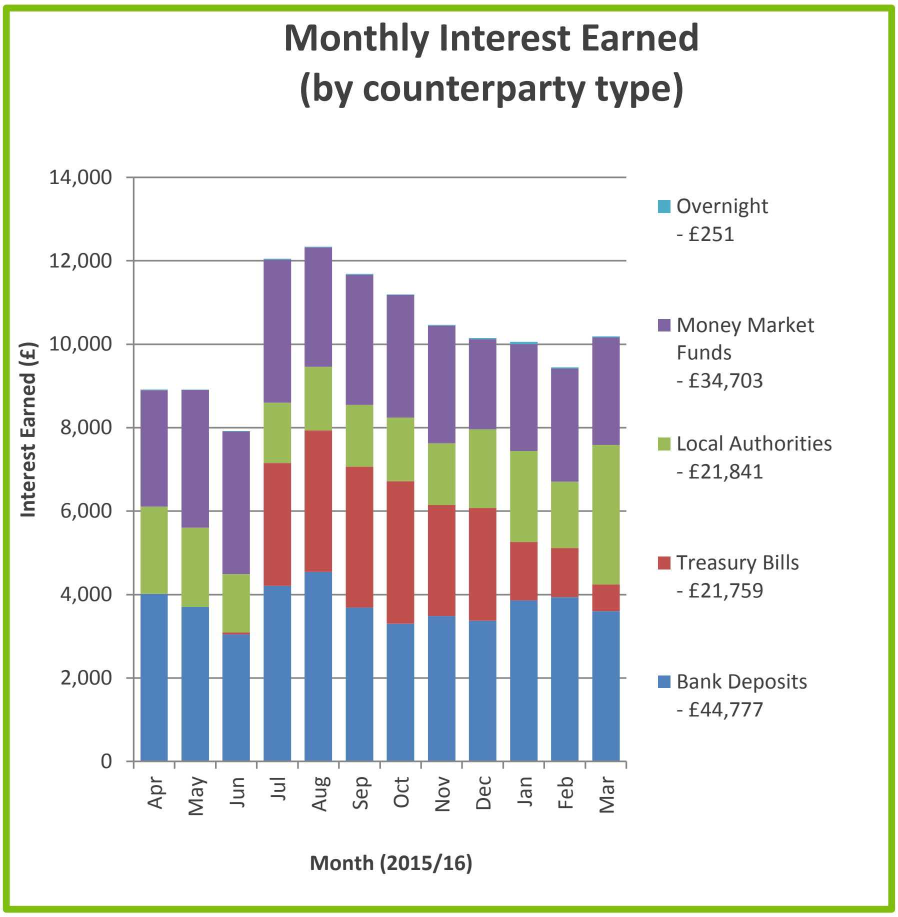


The level of cash reserves available to invest has followed the same pattern as seen in previous years. The Home Office Police Pensions Grant is received in July each year and has caused an annual spike in investments since 2007/08 when new regulations were introduced.

The average daily investment balance during 2015/16 was £24.29m (£29.24m in 2014/15).	The highest daily investment balance in 2015/16 was £34.28m (£38.58m in 2014/15)	The lowest daily investment balance in 2015/16 was £13.20m (£17.70m in 2014/15).

5.4.2. Interest

A total of £123k was earned in 2015/16 (£155k in 2014/15) from the Commissioner's treasury activities and can be broken down as follows:



Month	Interest Earned (£)
Apr	8,914
May	8,916
Jun	7,921
Jul	12,046
Aug	12,335
Sep	11,687
Oct	11,197
Nov	10,467
Dec	10,152
Jan	10,060
Feb	9,447
Mar	10,189
	123,331

The average return on investments for 2015/16 was 0.51% (0.53% in 2014/15) which is slightly above the bank base rate 0.50%. There we no changes in the base rate across the financial year.

The table at 4.4 shows the outturn on investment interest as £123k for 2015/16, which is £2k below a base budget of £125k. The reduction compared to budget is mainly in relation to interest rates staying lower for a longer period than originally anticipated.

5.4.3. Treasury Operations

As discussed in paragraph 4.2 above 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 2015/16 for the Commissioner's main bank account are summarised in the table below:

	Number of Days	Average Balance £	Largest Balance £
Days In Credit	364	1,600	30,529
Days Overdrawn	2	(3,344)	(3,342)

The largest credit balance occurred during the fourth quarter and an explanation is provided below and in paragraph 4.2 above. The largest overdrawn balance occurred during the first quarter of 2015/16 and an explanation was provided in the quarterly activity report to the Commissioner and Members.

The largest un-invested balance occurred on the 10 March 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.

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.

6. Compliance with Prudential Indicators

6.1. 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**.

7. Implications

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

7.2. Legal – None

7.3. 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).

7.4. HR / Equality – None

7.5. I.T – None

7.6. Procurement – None

8. Supplementary information

Attachments

Appendix 1 Recent history and projections of Bank Base Rates

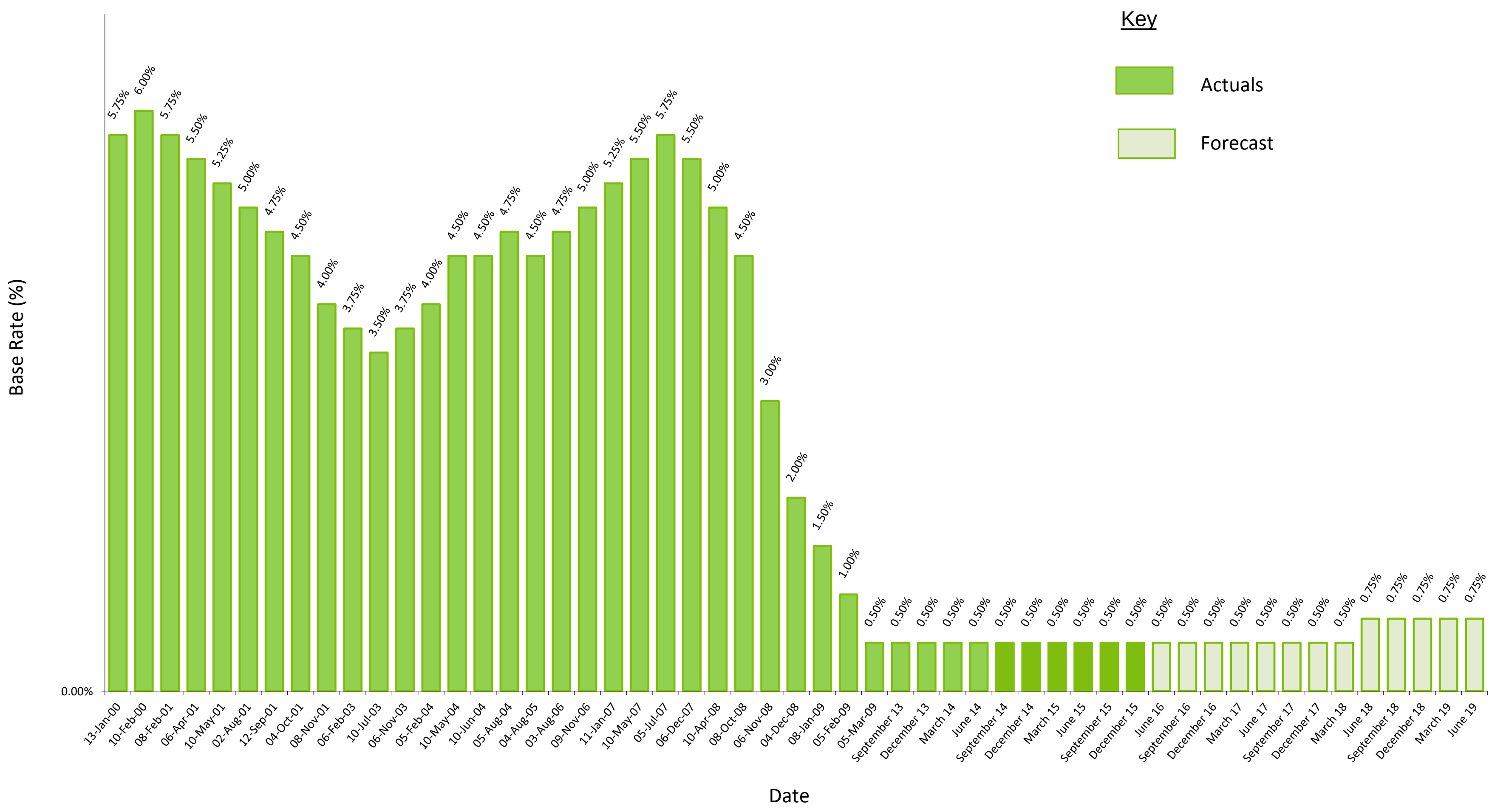
Appendix 2 Schedule of Investments as at 31 March 2016

Appendix 3 Analysis of Investments as at 31 March 2016

Appendix 4 Prudential Indicator Compliance

Appendix 1

Bank of England Base Rates (%s)



Appendix 2

Schedule of Investments as at 31 March 2016

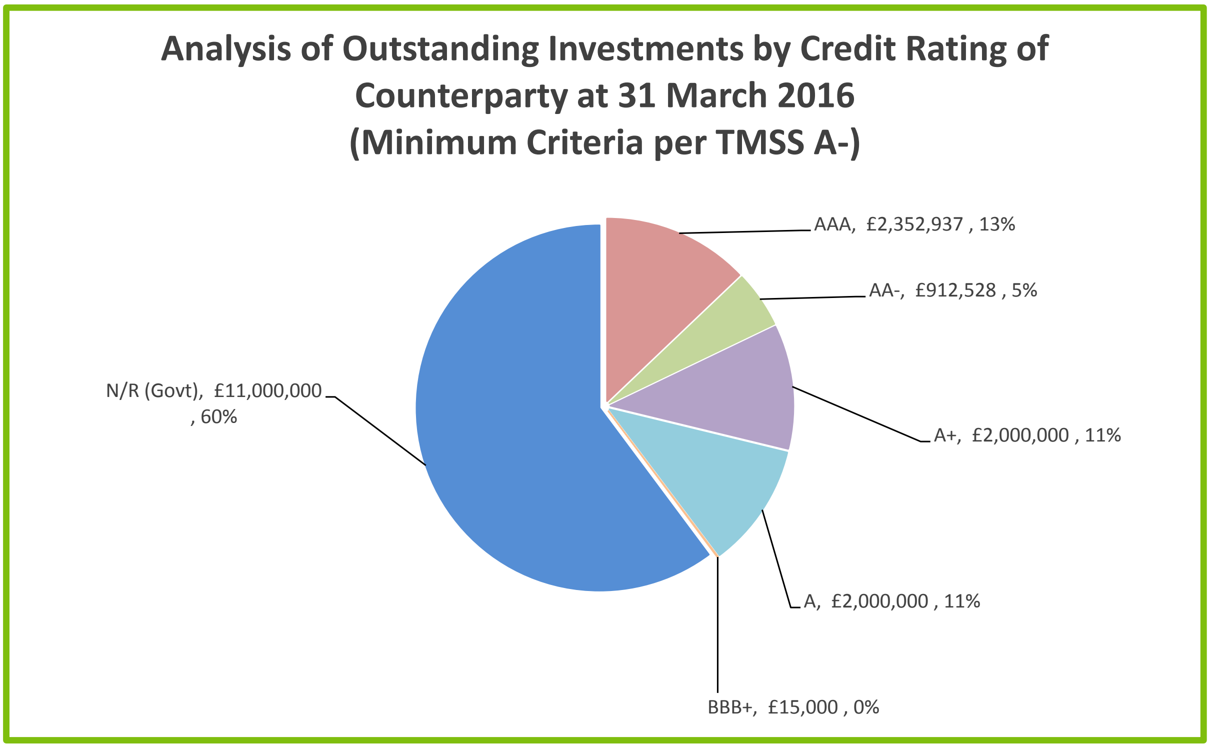
Category/Institution	Credit Rating	Investment Date	Investment Matures	Days to Maturity	Rate (%)	Amount (£)	Counterparty Total (£)
Category 1 - Banks Unsecured (Includes Banks & Building Societies)							
Nationwide	A	04/01/2016	30/06/2016	91	0.70%	2,000,000	2,000,000
Lloyds Bank Plc	A+	11/08/2015	11/08/2016	133	1.00%	2,000,000	2,000,000
Svenska (Deposit Account)	AA-	Various	On Demand	N/A	0.35%	912,528	912,528
NatWest (Liquidity Select Account)	BBB+	31/03/2016	01/04/2016	O/N	0.25%	15,000	15,000
						4,927,528	4,927,528
Category 2 - Banks Secured (Includes Banks & Building Societies)							
None						0	0
						0	**0**
Category 3 - Government (Includes HM Treasury and Other Local Authorities)							
Stirling Council	NR	18/12/2015	18/04/2016	18	0.50%	2,000,000	2,000,000
Lancashire County Council	NR	08/05/2015	06/05/2016	36	0.50%	2,000,000	2,000,000
Highland Council	NR	07/03/2016	07/06/2016	68	0.50%	2,000,000	2,000,000
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	251	0.60%	2,000,000	2,000,000
						11,000,000	**11,000,000**
Category 4 -Registered Providers (Includes Providers of Social Housing)							
None						0	0
						0	**0**
Category 5 -Pooled Funds (Includes AAA rated Money Market Funds)					**(Mar'16)**		
AIM	AAA	Various	On demand	O/N	0.49%	500,000	500,000
Fidelity	AAA	Various	On demand	O/N	0.43%	52,937	52,937
Standard Life (Formally Ignis)	AAA	Various	On demand	O/N	0.50%	1,800,000	1,800,000
						2,352,937	2,352,937
Total						**18,280,465**	**18,280,465**

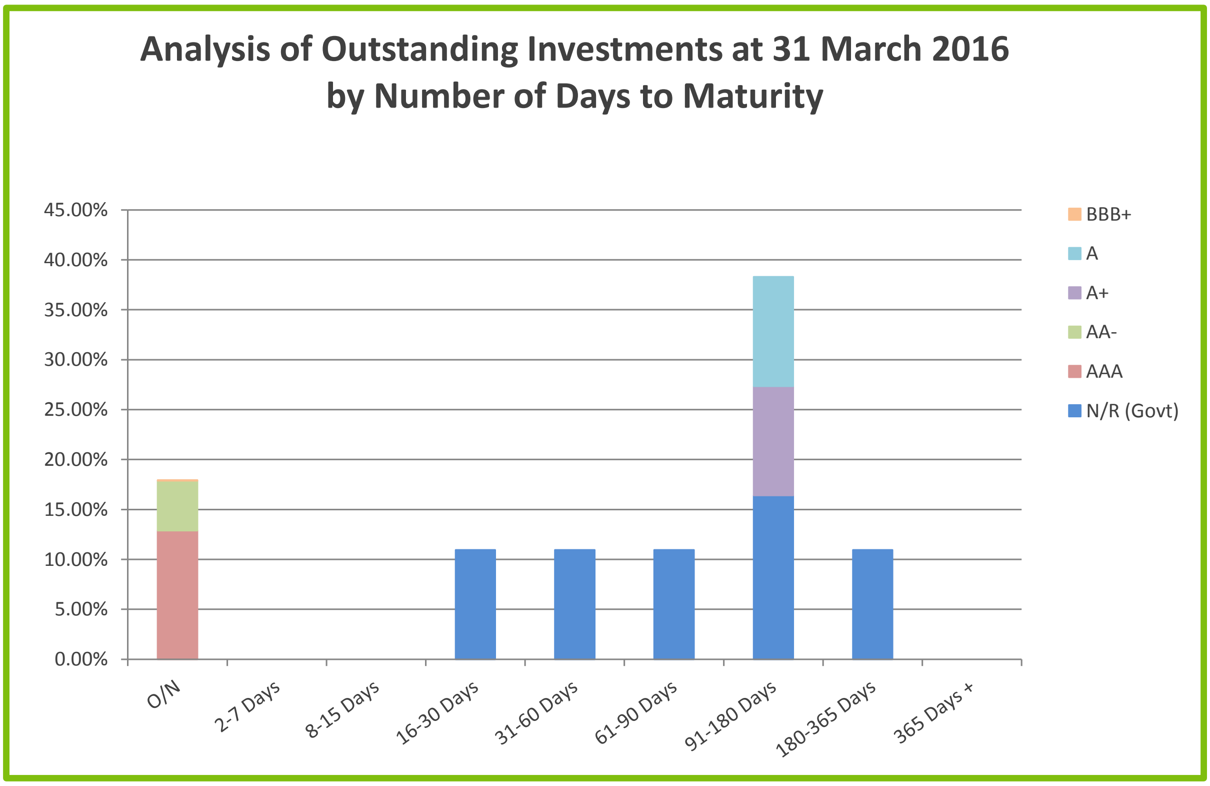
Note – the credit ratings shown in the above table relate to the standing as at 31 March 2016, as discussed in the main body of the report, the ratings are constantly subject to change.

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 31 March 2016





Note – the credit ratings shown in the above charts relate to the standing as at 31 March 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 £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 March 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 2015/16 £m	Actual Borrowing at 31 Mar'16 £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 Mar '16 £m	% Fixed Rate Borrowing as at 31 Mar '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 2015/16 was set at £5m.
- As at 31 March 2016, 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.