JOINT MANAGEMENT BOARD

ITEM : 4	**DATE: 4 November 2015**
TITLE: Treasury Management mid-year report 2015/16	
REPORT BY: Steve Freeman, Chief Finance Officer	

Executive Summary

In accordance with the updated CIPFA Treasury Management code of practice (2011) and to strengthen members' oversight of the PCC's treasury management activities, the PCC will receive updates on treasury management issues including a mid-year report. This report provides information on treasury management activity that has been undertaken in the current financial year and reports on the overall performance against the agreed strategy and prudential indicators.

Recommendations

The Police and Crime Commissioner is asked to note the report.

Signature

Police and Crime Commissioner

Date

PART I

POLICE & CRIME COMMISSIONER FOR LANCASHIRE

REVIEW OF TREASURY MANAGEMENT 2015/16 Mid-Year Report

Economic Overview

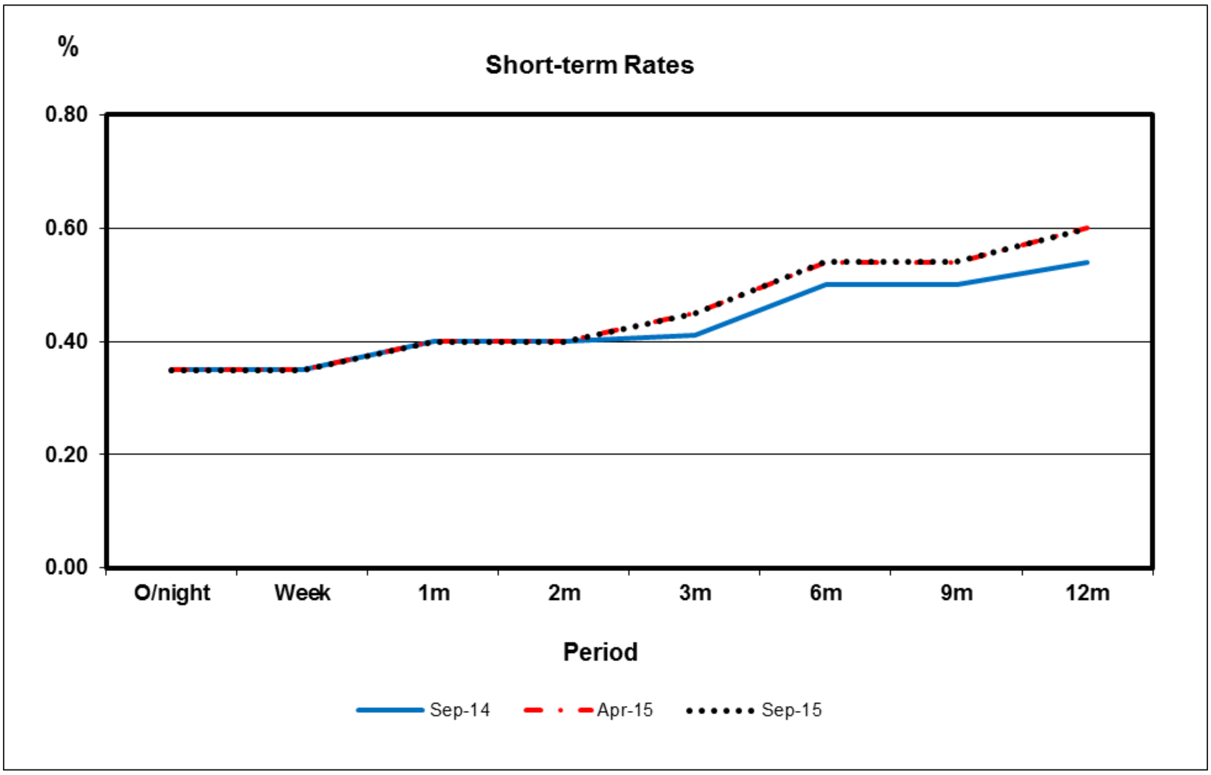
As the period progressed, economic data activity was largely overshadowed by events in Greece. Markets' attention centred on whether Greece would default on its debt repayments and the potential of Greece leaving the Euro. If Greece did leave the Euro it was expected that there would be a detrimental impact on other economies including the UK with the small risk of contagion into other Eurozone peripheral economies, such as Portugal, Ireland and Spain. After 61% of Greek voters chose to endorse a call for a "no" to more austerity, Greece's creditors refused to compromise and a default to the European Central Bank on 20th July 2015 looked possible. This would have put Greece's membership of the Euro in serious doubt. A Eurozone bailout agreement was reached to prevent a default. This has not ended the crisis as there will be an election in Greece in September which will delay, or potentially stop, the implementation on the austerity measures proposed as part of the bail-out.

Despite the global uncertainty, the UK economy remained resilient over the period. Economic growth slowed in Q1 2015 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 due to falls in energy and food prices. 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 unemployment rate for March fall to 5.5% of the economically active population. Average earnings excluding bonuses rose 2.2%.

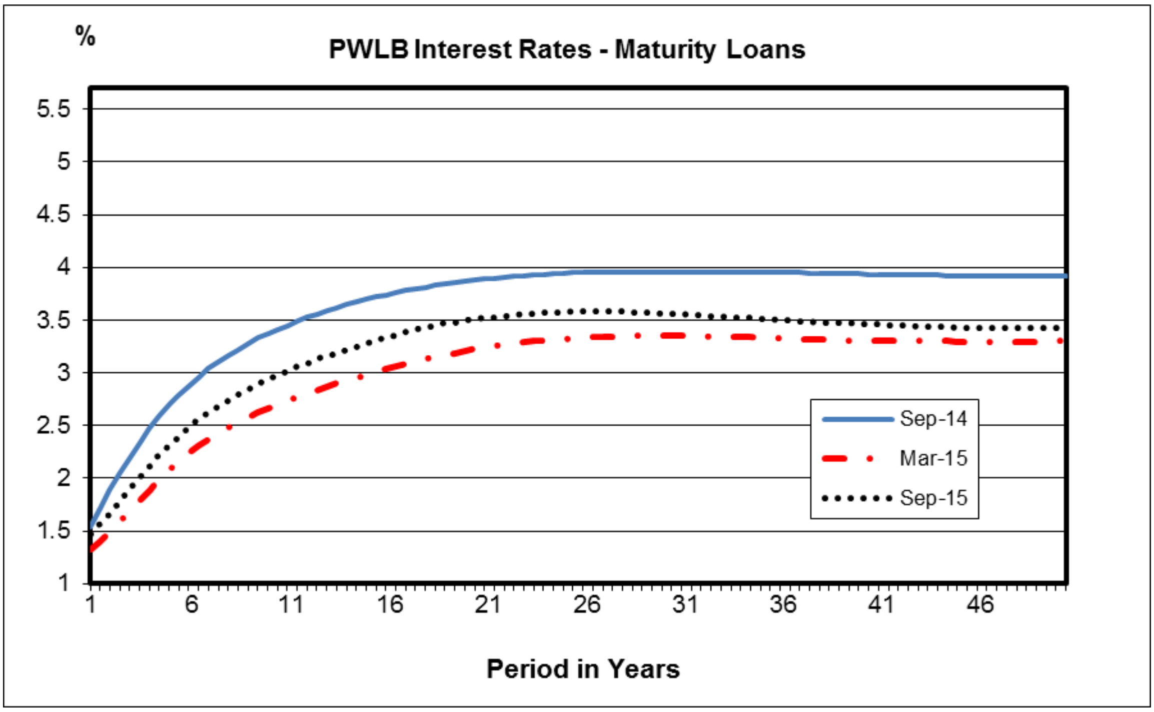
The outcome of the UK general election, largely fought over the parties' approach to dealing with the consequences of the structural deficit and the pace of its removal, saw some very big shifts in the political landscape and put the key issue of the UK's relationship with the EU at the heart of future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

Interest Rate Environment

Short term interest rates continue at the very low levels since the Bank of England reduced base rate to 0.5% in March 2009. The chart below shows that there has been very little movement in short term interest rates over the first three quarters of the calendar year.



Current longer term PWLB rates are shown below.



In September 2014 central bank liquidity injections and the abatement of the euro debt crisis resulted in a reduction in demand for safe haven assets, including UK Government gilts, and a consequent rise in interest rates. Towards the end of the financial year however geopolitical factors weighed heavily on gilt yields and consequently in Public Works Loan Board interest rates, with a noticeable flattening of the curve as rates fell back towards record low levels. The first half of 2015-16 has seen some modest rate increases, but the re-emergence of the Greek debt crisis, the uncertainty over timing of US and UK monetary policy tightening and turmoil in the Chinese stock market have resulted in increased bond price and interest rate volatility.

Outlook for Interest Rates

Treasury Consultants Arlingclose Ltd forecast the first rise in official interest rates in Q2 2016. Inflation remains benign and below target, but is expected to rise towards the end of 2015, and wage growth has returned to the economy and is being very closely monitored by the Monetary Policy Committee. Although these factors eventually will make interest rate rises necessary, Arlingclose expect the new normal level to be lower than the previous norm at between 2 and 3%.

Period	Bank Rate	3 month LIBID	12 month LIBID	20-year Gilt Rate
Q3 2015	0.50	0.55	1.00	2.40
Q4 2015	0.50	0.60	1.05	2.45
Q1 2016	0.50	0.70	1.20	2.50
Q2 2016	0.75	0.80	1.35	2.55
Q3 2016	0.75	0.95	1.45	2.60
Q4 2016	1.00	1.05	1.55	2.65
Q1 2017	1.00	1.15	1.70	2.70
Q2 2017	1.25	1.30	1.80	2.75
Q3 2017	1.25	1.40	1.95	2.80
Q4 2017	1.50	1.55	2.00	2.85
Q1 2018	1.50	1.65	2.10	2.90
Q2 2018	1.75	1.80	2.15	2.95

Borrowing

Since 2008-09 the Police & Crime Commissioner for Lancashire cash investments have been in excess of the borrowing requirement and so to avoid excess borrowing and in order to reduce credit rate risk, balances have been used to fund capital programme expenditure and no borrowing has been taken over this period.

	2015-16	**2016-17**	**2017-18**
	Actual	**Estimate**	**Estimate**
	£m	**£m**	**£m**
Capital Programme Borrowing	6.825	14.462	2.500
Borrowing requirement b/fwd from previous year	22.285	26.360	12.230
Maturing Debt	0.500	0.500	1.100
Less Statutory MRP (PWLB only @ 4%)	-1.288	-1.300	-1.304
Total Borrowing Requirement	**28.322**	**40.022**	**14.526**

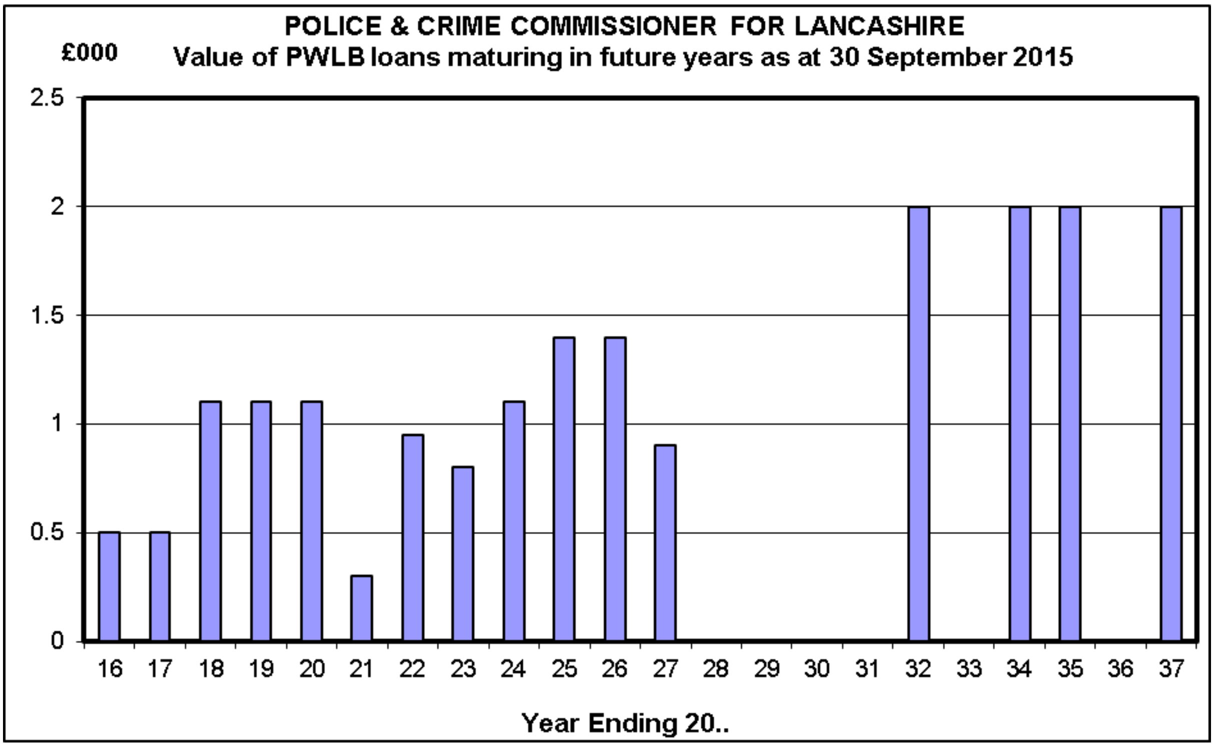
The borrowing requirement represents capital expenditure which has not yet been financed by from any external source. It is currently financed internally to the organisation by borrowing from balances. At present the Commissioner's balances are sufficient to cover this internal borrowing and as investment interest rates are at historically low levels internal borrowing is more cost effective than traditional external borrowing from the Public Works Loan Board (PWLB).

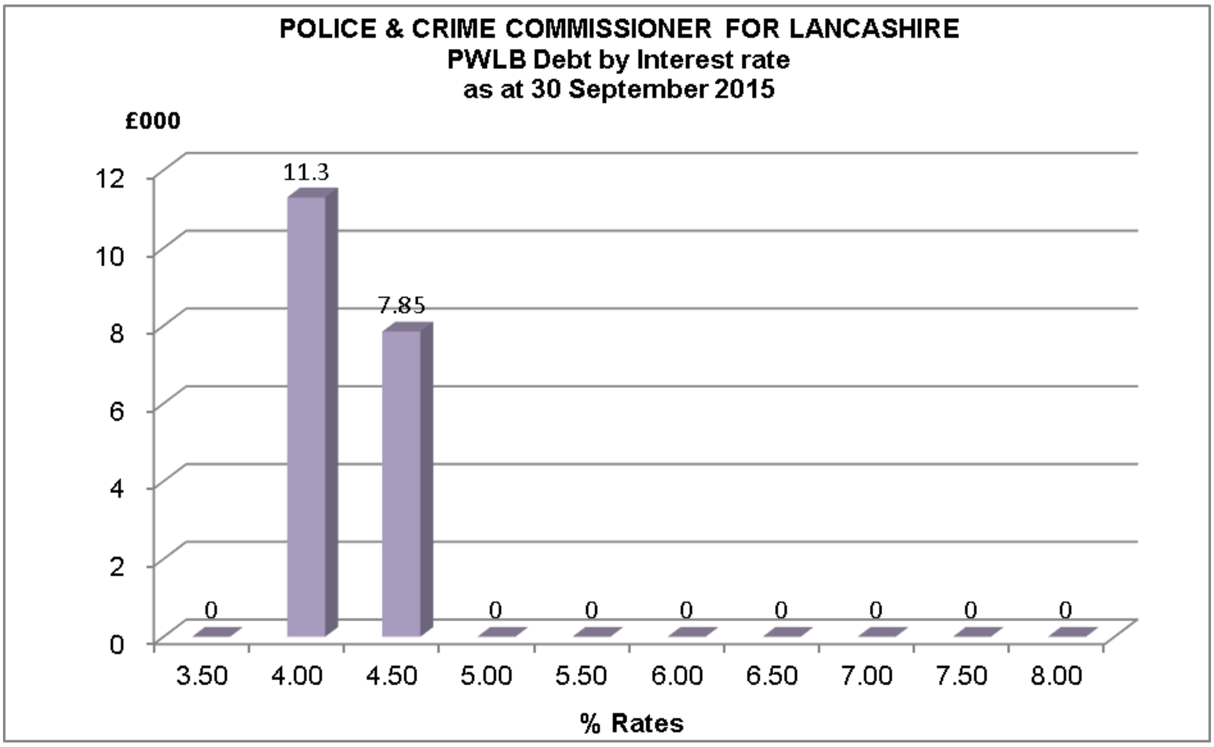
All of PCC's borrowing is currently from the Public Works Loan Board. The current long term debt outstanding is £19.154m. The next scheduled repayment is in September 2015 when outstanding debt will fall to £18.654m. It is possible to repay debt early, but the PWLB will charge a premium for early repayment loss of interest.

	2015-16	**2016-17**	**2017-18**
	Actual	**Estimate**	**Estimate**
	£m	**£m**	**£m**
Total Debt Outstanding	**19.154**	**18.654**	**18.154**
In year debt repayment	-0.500	-0.500	-1.100
New Borrowing	-	-	-
Total Debt Outstanding	**18.654**	**18.154**	**17.054**

The Chief Finance Officer reviews debt restructuring opportunities on a regular basis. The last review conducted in October 2014 found that given the relatively favourable interest rates at which these have been taken out (below 5%) and the penalties associated with any early repayment it is not considered financially viable to do so at the present time. The Chief Finance Officer will continue to monitor the internal borrowing strategy in the light of economic and interest rate forecasts.

The charts over the page show the current maturity profile of the Commissioner's borrowings, along with an analysis of the debt by interest rate.





Investments

Both the CIPFA Code and the CLG Guidance require the Authority to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Authority's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk receiving low investment returns and having the value of reserves eroded by inflation.

The re-addition of the other counterparties into the investment policy is intended to improve investment returns whilst retaining the very high credit quality of the portfolio.
Until recently investment rates for shorter than one year were below the PCC current call account rate of 0.5% and therefore the full amount of the PCC balances were held within the call account.

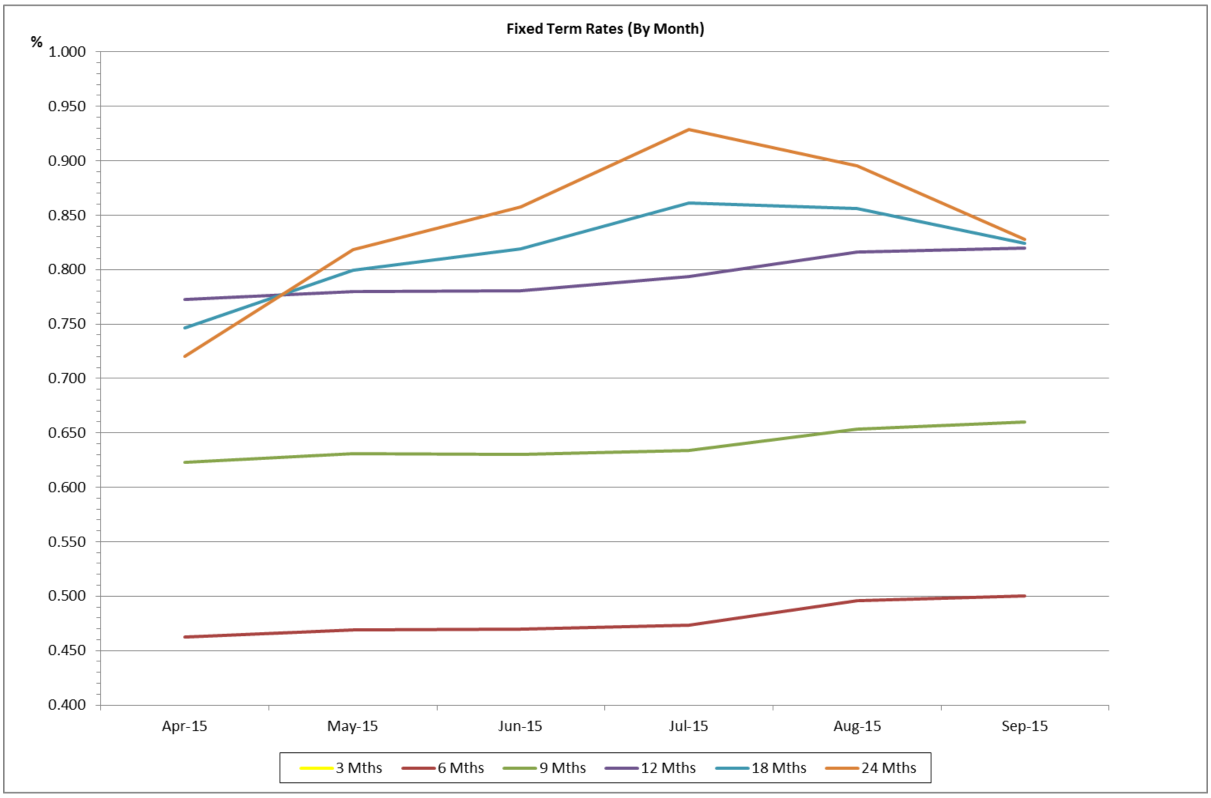
However given the current level of balances and capital forecast expenditure profiles it is considered that a proportion of balances could be invested for a longer period and so increase the amount of interest which will accrue to the Commissioner's revenue account.

In accordance with this policy a long term loan has been placed with a UK local authority as outlined below:

Start Date	End Date	Principal	Rate	Annual Interest	Interest 2014/15
22/10/14	23/10/17	£5,000,000	1.50%	£75,000	£32,877

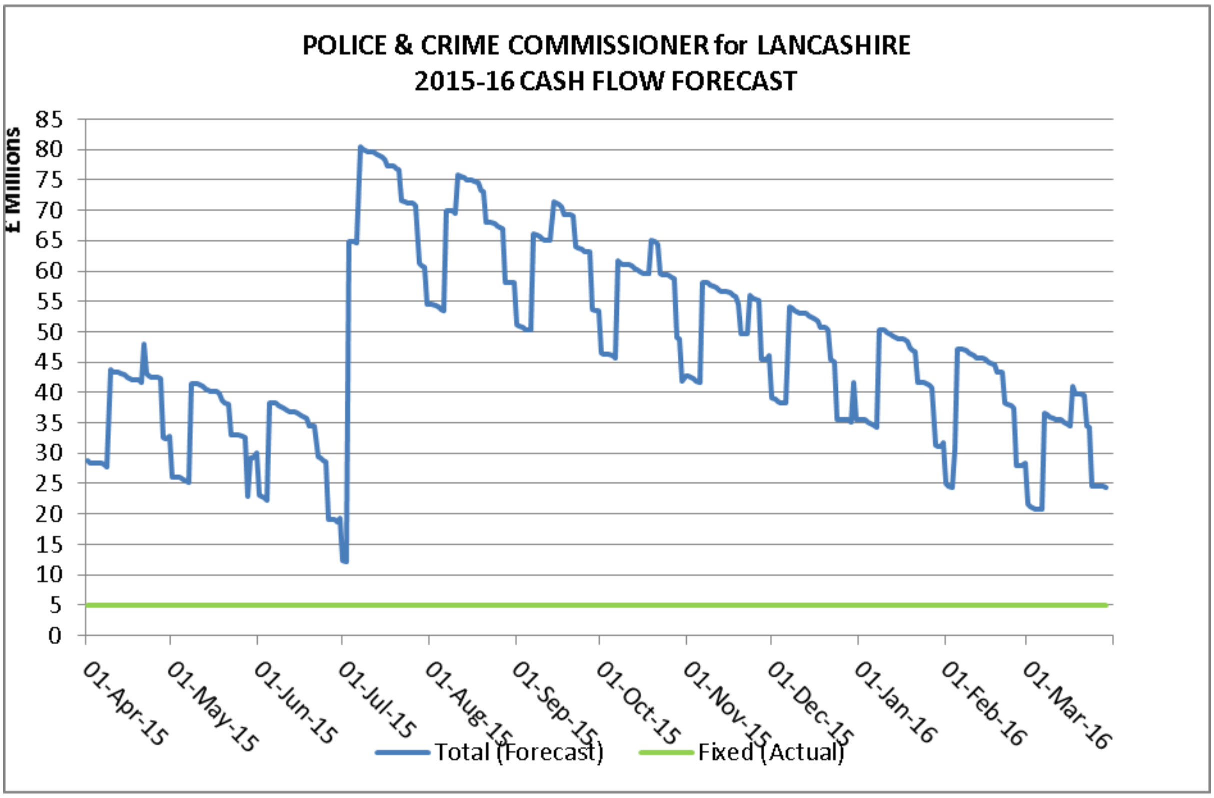
In addition to this the Commissioner has access to the call account provided by Lancashire County Council paying base rate. Each working day the balance on the Commissioner's Current Account is invested in this to ensure that the interest received on surplus balances is maximised. During the period a £5m investment was also made in a very high quality senior secured bond fund in order to enhance the yield above the call account rate. The fund makes quarterly distributions but at the time of this report a quarter end has not yet been reached, the first distribution is expected to return an annualised rate around 0.65%.
The overall combined amount of interest earned on fixed and call balances as at 31st August 2015 is £134k on an average balance of £54m at an average rate of 0.60%. This compares favourably with the benchmark 7 day notice index which averages 0.47% over the same period.

The chart below shows the current interest rates for different investment maturities. In order to increase the rate earned on current balances, the commissioner would need to place fixed investments of 9 months duration. The interest rate environment is slowly rising though and this is being carefully monitored by the Chief Financial Officer.



Cash Flow

The estimated cash flow totals are as follows:



This graph shows the total cash level held by the Authority. There is a regular pattern as cash is bolstered by precept receipts each month followed by falls as expenditure is incurred. The large cash injection from the low point at the beginning of July is the pensions top up grant. The green line shows how much of the Authority's cash is placed on fixed deposit to earn additional interest.

Prudential Indicators

In order to control and monitor PCC's treasury management functions, a number of prudential indicators are determined against which performance may be measured. The indicators for 2015/16 are shown in the table below alongside the current actual and none of the indicators have been breached over the period.

	2015-16 PIs	**Actual to Date**
Adoption of the CIPFA Code of Practice for Treasury Management	Adopted	Adopted
Authorised limit for external debt	£000	£000
A prudent estimate of total external debt, which does not reflect the worst case scenario, but allows sufficient headroom for unusual cash movements		
Borrowing	30.000	19.154
Other long-term liabilities	1.000	-
Total	31.000	19.154
Operational boundary for external debt		
A prudent estimate of debt, but no provision for unusual cash movements. It represents the estimated maximum external debt arising as a consequence of the Authority's current plans		
Borrowing	27.000	19.154
Other long-term liabilities	1.000	-
Total	28.000	19.154

	2014-15 PIs	**Actual to Date**
Upper limit for fixed interest rate exposure		
Borrowing	100%	100%
Investments	100%	7%
Upper limit for variable rate exposure		
Borrowing	75%	0%
Investments	100%	93%
Upper limit for total principal sums invested for over 364 days (per maturity date)	75%	Nil
Maturity structure of debt	**Upper/ Lower Limits**	**Actual**
Under 12 months	50% / nil	2.61%
12 months and within 24 months	50% / nil	2.61%

24 months and within 5 years	50% / nil	17.23%
5 years and within 10 years	80% / nil	23.78%
10 years and above	90% / 25%	53.77%

Business Risk Implications

The Treasury Management strategy is designed to minimise the PCC for Lancashire's financial risk associated with investment decisions, whilst maximising the return on any investments made. As such the adoption of the CIPFA's Code of Practice on Treasury Management and the monitoring arrangements in place ensure that any risks faced by PCC are managed.

However, it must be acknowledged that there will always be a balance between risk and return and hence the strategy does not completely eliminate the risk of any further default on investments in the future.

1. **Links to the Police and Crime Plan**

2. **Consultation**

3. **Implications**

   a. **Legal**

   There are no legal comments associated with this paper.

   b. **Financial**

   The financial implications are contained in the report

   c. **Equality considerations**

   There are no Equality comments associated with this paper.

4. **Background Papers**

   CIPFA Treasury Management Code of Practice (2011)
   PCC for Lancashire Treasury Management Strategy 2015/16

5. **Public access to information**

   Information in this form is subject to the Freedom of Information Act 2000 and other legislation.

   Part 1 of this form will be made available on the PCC website within 3 working days of approval. Any facts/advice/recommendations that should not be made available on request should not be included in Part 1 but instead on the separate Part 2 form.

Officer declaration	Date
LEGAL IMPLICATIONS – As above	
FINANCIAL IMPLICATIONS – As above	
EQUALITIES IMPLICATIONS – As above	
CONSULTATION – As above	

Director to the Office of the Police and Crime Commissioner (Monitoring Officer)

I have been informed about the proposal and confirm that financial, legal and equalities advice has been taken into account in the preparation of this report. I am satisfied that this is an appropriate request to be submitted to the Police and Crime Commissioner for Lancashire.

Signature……………………………………………..Date………………………..