

Joint Audit Committee

20th June 2016

Warwickshire and West Mercia Police and Crime Commissioners

Treasury Management Outturn Report 2015/16 And Review of the 2016/17 Treasury Management Strategy

Recommendation

The Committee is asked to consider and comment on the Treasury Management Outturn Report for 2015/16 and the Review of the 2016/17 Treasury Management Strategy before its consideration by the Warwickshire and West Mercia Police and Crime Commissioners.

The Committee is asked to support the changes to the counterparty list and investment limits outlined in the report and to note the introduction of separate limits for Warwickshire and West Mercia.

The Committee is asked to support the piloting of additional Treasury Management Indicators.

The Committee is asked to support a review of the Minimum Revenue Provision (MRP) Policy and Provision by the Treasury Management Advisors.

1. Introduction

1.1 Warwickshire and West Mercia Police and Crime Commissioners fully comply with the requirements of The Chartered Institute of Public Finance and Accountancy's (CIPFA's) Code of Practice (COP) on Treasury Management 2011. The primary requirements of the Code are the:

- creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Police and Crime Commissioner's treasury management activities and is informed by the Medium Term Capital Programme.
- creation and maintenance of Treasury Management Practices which set out the manner in which the Police and Crime Commissioner will seek to achieve those policies and objectives;

- receipt by the Police and Crime Commissioner of an annual treasury management strategy report for the year ahead, a midyear review report (as a minimum) and an annual review report of the previous year;
 - delegation by the Police and Crime Commissioner of responsibilities for implementing and monitoring treasury management policies and practices, and for the execution and administration of treasury management decisions.
 - delegation by the Police and Crime Commissioner of the role of scrutiny of treasury management strategy and policies to a specific named body. In this respect the Police and Crime Commissioner has chosen to delegate this responsibility to the Joint Audit Committee
- 1.2 Therefore, under the CIPFA Code, the Police and Crime Commissioner is required to receive a report on the outturn of the annual treasury management activity.
- 1.3 Treasury management in the context of this report is defined as:
- “The management of the Police and Crime Commissioner’s cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks.” (*CIPFA Code of Practice*).
- 1.4 The Police and Crime Commissioner is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. Part of the treasury management operation is to ensure that this cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in low risk counterparties or instruments commensurate with a low risk appetite, providing security of capital and sufficient liquidity initially before considering investment return.
- 1.5 The second main function of the treasury management service is the funding of the Police and Crime Commissioner’s capital plans. These capital plans provide a guide to the borrowing need of the Police and Crime Commissioner, essentially the longer term cash flow planning to ensure that the Police and Crime Commissioner can meet his capital spending obligations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses. On occasions, debt previously drawn may be restructured to meet the Police and Crime Commissioner’s risk or cost objectives.

- 1.6 The Police and Crime Commissioners approved a Treasury Management Strategy for 2016/17. At the time it was noted that this would be reviewed during the first quarter of 2016/17 because of changes to the counterparty list and their investment limits and the operational impact of these changes on Treasury Management activities. This report outlines further changes to the counterparty list and the investment limits following this review.

2 The Police and Crime Commissioners' Current Treasury Position

- 2.1 The Police and Crime Commissioners raise long-term borrowing to fund capital expenditure, i.e., expenditure on land, buildings and equipment. The Police and Crime Commissioners did not take any new borrowing in 2015/16. There was £15.8m of long-term borrowing for Warwickshire and £10m of long-term borrowing for West Mercia as at 31 March 2016.
- 2.2 At the same time as borrowing for capital purposes, the Police and Crime Commissioners also have an investment portfolio. This consists of the Police and Crime Commissioner's reserves and short-term cash flows. This cash was invested in-house.
- 2.3 As at 31 March 2015, the Police and Crime Commissioner for Warwickshire had £38.5m of cash investments and this had reduced to £29m by 31 March 2016. Table 1.1 shows the Police and Crime Commissioner's debt and investment position at the beginning and the end of the year was as follows:

Table 1: Summary of Treasury Position for Warwickshire at 31 March

	Principal at 31.03.15	Rate/ Return	Principal at 31.03.16	Rate/ Return for 15/16
A: Fixed Rate Funding	£m	%	£m	%
Public Works Loans Board Debt	16.7	4.68	15.8	4.68
Total Debt	16.7	4.68	15.8	4.68
B: Investments				
In House	38.5	0.41	29.0	0.42
Total Investments	38.5	0.41	29.0	0.42

- 2.4 As at 31 March 2015, the Police and Crime Commissioner for West Mercia had £50m of cash investments and this had reduced to £46m by 31 March 2016. Table 2 shows the Police and Crime Commissioner's debt and investment position at the beginning and the end of the year was as follows:

Table 2: Summary of Treasury Position for West Mercia at 31 March

	Principal at 31.03.15	Rate/ Return	Principal at 31.03.16	Rate/ Return for 15/16
A: Fixed Rate Funding	£m	%	£m	%
Public Works Loans Board Debt	10.0	4.44	10.0	4.44
Total Debt	10.0	4.44	10.0	4.44
B: Investments				
In House	50.0	0.50	46.0	0.42
Total Investments	50.0	0.30	46.0	0.42

3 Treasury Management Strategy for 2015/16

- 3.1 The Police and Crime Commissioner approved the Treasury Strategy for 2015/16 in July 2015.
- 3.2 The expectation for interest rates within the strategy for 2015/16 anticipated the Bank Rate remaining at its historic low for the duration of the financial year. This has proved to be the case. .

4 The Economy and Investment Rates in 2015/16

- 4.1 The financial year 2015/16 continued the challenging investment environment of previous years, namely low investment returns and continuing heightened levels of counterparty risk. The original expectation for 2015/16 was that Bank Rate would remain consistent at its historic low throughout the year.
- 4.2 Economic growth in the UK continued during 2015/16.
- 4.3 The Bank Rate ended the year unchanged at 0.5%

5 Borrowing Outturn for 2015/16

- 5.1 Due to the slippage in the capital programme, the Police and Crime Commissioners did not take any PWLB borrowing in 2015/16. The £16.4m of capital spend was funded from the revenue under spend (£7.467m), and capital grants (£8.97m). In 2015/16 borrowing costs for West Mercia were £0.444m compared to a budget of £0.444m. Borrowing costs for Warwickshire were £0.773m compared to a budget of £1.186m. The 2016/17 budget has been reduced to reflect the scheduled repayments of principal sums. The outturn is explained further in the revenue and capital outturn report.

6 Compliance with Treasury Limits and Prudential Indicators

- 6.1 During the financial year the Police and Crime Commissioner operated within the treasury limits and Prudential Indicators set out in the Police and Crime Commissioner's Treasury Policy Statement and Treasury Management Strategy.
- 6.2 Full details of the Prudential indicators set for 2015/16 and the results for the year are shown in **Appendix A**.

7 Investment Rates 2015/16

- 7.1 The Bank Rate remained at its historic low of 0.50% throughout the year; it has now remained unchanged for seven years

8 Investment Outturn for 2015/16

- 8.1 The Police and Crime Commissioner's investment policy was governed by CLG guidance, which was been implemented in the annual investment strategy approved by the Police and Crime Commissioner in July 2015. This policy sets out the approach for choosing investment counterparties, and is based on credit ratings provided by the three main credit rating agencies supplemented by additional market data (such as rating outlooks, credit default swaps, bank share prices etc).
- 8.2 The Police and Crime Commissioners manage their short-term cash balances in-house and invest with the institutions listed in the Police and Crime Commissioner's approved lending list. In 2015/16 the Police and Crime Commissioners have invested for a range of periods from overnight to one year, dependent on the Police and Crime Commissioner's cash flows, its interest rate view and the interest rates on offer. Table 3 summarises the investment performance for 2015/16.

Table 3: Investment Outturn 2015/16

	Average balance of Investments £m	Rate of Return %	Benchmark Return %
Internally Managed - Warwickshire	29	0.42	0.41
Internally Managed – West Mercia	46	0.42	0.43

8.3 Investment income for West Mercia in 2015/16 was £0.207m compared to a budget of £0.115m, and for Warwickshire investment income was £0.132m compared to a budget of £0.101m.

8.4 No institutions in which investments were made had any difficulty in repaying investments and interest in full during the year.

9 Debt Rescheduling for 2015/16

9.1 No debt rescheduling was undertaken in 2015/16.

10 Review of the 2016/17 Treasury Management Strategy

10.1 Review of Investment Strategy

As indicated in the 2016/17 Treasury Management Strategy, the Vice Chair of the Audit Committee and the Treasurer have undertaken a review of the current Approved Investment Counterparties and Investment limits in line with current best practice set out by Arlingclose, the Commissioners' Treasury Management Advisors.

The Commissioners hold significant invested funds, representing income received in advance of expenditure plus balances and reserves held. In the past 12 months, the Commissioner for Warwickshire's investment balance has ranged between £29m and £38m with the investment balance for the Commissioner for West Mercia ranging between £46m and £50m.

Both the CIPFA Code and the CLG/Home Office guidance require the Commissioners' to invest their funds prudently and to have regard to the security and liquidity of their investments before seeking the highest rate of return or yield. Their 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 of receiving unsuitably low investment income.

The Commissioners' surplus cash is currently invested with the Debt Management Office (DMO), local authorities and short term unsecured bank/building society deposits. Given the increasing risk and continued low returns from short –term unsecured bank investments and from investments with the DMO and local authorities, the Commissioners will diversify further into more secure and/or higher yielding assets. It is proposed that the Commissioners will in future be able to invest in Money Market Funds and with Registered Providers (Housing Associations). It is also proposed that in future the Commissioners have the ability to invest for a longer time period, of between 1 and 3 years. The use of this will be limited due to forecasted cash flow projections and the estimated borrowing required to finance the Medium Term Capital Programme (2016/17 – 2019/20).

The Commissioners will not during 2016/17 invest funds in investments secured on bank assets such as covered bonds, reverse purchase agreements and other collateralised agreements. Nor will they invest in loans, bonds and commercial papers issued by companies other than banks, building societies and registered providers. The Commissioners will explore the use of these funds during 2016/17 in preparation for 2017/18. The Commissioners will continue to adopt best practice and monitor developments in public sector borrowing and lending.

The approved counterparty limits have been reviewed in line with best practice and in future will be broadly based on a percentage of reserves held by the Commissioners. This will lead to the investment limits being lower for the funds held by the Commissioner for Warwickshire than those held by the Commissioner for West Mercia.

Having considered the volatility in the daily cash flow balances and the need for greater flexibility in their management, the counterparty limits for the current account bankers (£5m) will remain unchanged during 2016/17.

10.2 Approved Counterparties

Approved Counterparty Limits for Warwickshire

The Commissioner for Warwickshire may therefore invest surplus funds with any of the counterparty types in the table below, subject to the cash limits (per counterparty) and the time limits shown.

Credit Rating	Banks	Government (incl Local Authorities)	Registered Providers (Housing Associations)
UK Govt.	n/a	£ Unlimited 50 years	n/a
AAA, AA+, AA, AA-	£2m 3 years	£3m 3 years	£2m 3 years
A+	£2m 2 years	£2m 2 years	£2m 2 years
A	£2m 13 months	£2m 2 years	£2m 2 years
A-	£2m 6 months	£2m 2 years	£2m 2 years
BBB+	£1m 3 months	£1m 1 year	£1m 1 year
UK Building Societies without Credit Ratings	£1m 6 months	n/a	n/a
UK Local Authorities and PCCs	n/a	£3m 3 years	n/a
Money Market Funds	£2m per fund		
Current Account Bank (Lloyds) if the credit rating is A- or above	£5m 1 year	n/a	n/a
Current Account Bank (Lloyds) if it fails to meet the above criteria	£1m Next working day	n/a	n/a

Approved Counterparty Limits for West Mercia

The Commissioner for West Mercia may therefore invest surplus funds with any of the counterparty types in the table below, subject to the cash limits (per counterparty) and the time limits shown.

Credit Rating	Banks	Government (incl Local Authorities)	Registered Providers (Housing Associations)
UK Govt.	n/a	£ Unlimited 50 years	n/a
AAA, AA+, AA, AA-	£3m 3 years	£6m 3 years	£3m 3 years
A+	£3m 2 years	£3m 2 years	£3m 2 years
A	£3m 13 months	£3m 2 years	£3m 2 years
A-	£3m 6 months	£3m 2 years	£3m 2 years
BBB+	£2m 3 months	£2m 1 year	£2m 1 year
UK Building Societies without Credit Ratings	£2m 6 months	n/a	n/a
UK Local Authorities and PCCs	n/a	£6m 3 years	n/a
Money Market Funds	£3m per fund		
Current Account Bankers (HSBC) if the credit rating is A- or above	£5m 1 year	n/a	n/a
Current Account Bankers (HSBC) if it fails to meet the above criteria	£1m Next working day	n/a	n/a

10.3 Specified Investments

The CLG guidance defines specified investments as:

- Denominated in pounds sterling
- Due to be repaid within 12 months of arrangement
- Not defined as capital expenditure by legislation, and
- Invested with one of the UK government, a UK local authority, parish council or community council or a body or investment scheme of “high credit quality”.

The Commissioners will continue to define “high credit quality” organisations and securities as those having a credit rating of A- or higher that are domiciled in the UK or a foreign country with a sovereign rating of AA+ or higher For money market funds “high quality credit” is defined as those having a credit rating of A- or higher.

10.4 Non-specified investments

Any investment not meeting the definition of a specified investment is classed as non-specified. The Commissioners do not intend to make any investments denominated in foreign currencies, nor any that are defined as capital expenditure by legislation, such as company shares. Non-specified investments will therefore be limited to long-term investments those that are due to mature 12 months or longer from the date of arrangement, and investments with bodies and schemes not meeting the definition on high credit quality. The Commissioners will now set separate limits for Warwickshire and West Mercia. Limits on non-specified investments are shown in the table below.

	Warwickshire Cash Limit	West Mercia Cash Limit
Total long-term investments	£5m	£10m
Total investments without credit ratings or rated below A-	£5m	£10m
Total investments with institutions domiciled in foreign countries rated below AA+	£0m	£0m
Total non specified investments	£10m	£20m

10.5 Investment Limits

The Commissioner for Warwickshire’s revenue reserves available to cover investment losses are £33.995m on 31st March 2016. In order that no more than 10% of available reserves will be put at risk in the case of a single default the maximum that will be lent to any one organisation other than the UK government will be £3m. The Commissioner for West Mercia’s revenue reserves available to cover investment losses are £64.166m on 31st March 2016. In order that no more than 10% of available reserves will be put at risk in the case of a

single default the maximum that will be lent to any one organisation other than the UK government will be £6m. A group of banks under the same ownership will be treated as a single organisation for limit purposes. Limits will also be placed on fund managers and investments in industry sectors as below:

	Warwickshire Cash Limit	West Mercia Cash Limit
Any single organisation, except the UK Central Government	£3m	£6m
UK Central Government	Unlimited	Unlimited
Any group of organisations under the same ownership	£3m per group	£6m per group
Registered Providers (Housing Associations)	£6m	£12m
Unsecured Investments with Building Societies	£6m	£12m
Money Market Funds	£9m	£17m

10.6 Liquidity Management

The Commissioners are currently developing their cash flow management and forecasting arrangements to determine the maximum period for which funds may prudently be committed. They are considering the purchase of purpose-built cash flow forecasting software. Current forecasts are compiled on a prudent basis to minimise the risk of the Commissioners being forced to borrow on unfavourable terms to meet their financial commitments. Limits on long term investments are set by reference to the Authority's medium term financial plan and cash flow forecast.

10.7 Treasury Management Indicators

The Commissioners measure and manage their exposure to treasury management risks using Treasury Management indicators governing upper limits for fixed and variable rate exposure. Having reviewed best practice, it is proposed that the following further indicators be piloted on a trial basis.

Security

The Commissioners will pilot a voluntary measure of their exposure to credit risk by monitoring the value weighted average credit rating/credit score of their investment portfolios.

	Target
Portfolio average credit rating for Warwickshire	A+
Portfolio average credit rating for West Mercia	A+

Liquidity

The Commissioners will pilot a voluntary measure of their exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments within a rolling three month period without additional borrowing.

	Target
Total Cash Available for 3 months for Warwickshire	£14.2m
Total Cash Available for 3 months for West Mercia	£31.0m

Principal Sums Invested for Periods Longer than 364 days

The purpose of this indicator is to control the Commissioners' exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the long-term principal sum invested to final maturities beyond the period end will be:

	Target
Limit on principal invested beyond the year end for Warwickshire	£5m
Limit on principal invested beyond the year end for West Mercia	£10m

This target will be set separately for 2016/17, 2017/18 and 2018/19.

11 Review of Existing PWLB Loans Portfolios.

- 11.1 The existing PWLB loans portfolios for Warwickshire and West Mercia have been reviewed by the Treasurer and Arlingclose, the Treasury Management Advisors.
- 11.2 The Police and Crime Commissioner for Warwickshire holds PWLB loans with principal outstanding of £15.838m. 4 loans with a value of £6.55m relate to the Criminal Justice Centres where the 4 partners fund 50.84% of the financing costs (interest and principal repayments) each year. Currently there is no financial benefit to the Commissioner in restructuring the PWLB loans portfolio.
- 11.3 The Police and Crime Commissioner for West Mercia holds 2 PWLB loans with principal outstanding of £10m. Currently there is no financial benefit in the medium to long term to the Commissioner in restructuring the PWLB loans portfolio.
- 11.4 Both Police and Crime Commissioners will continue to monitor the options of rescheduling and repaying debts during the course of the year.

12 Review of MRP Policy

- 12.1 The Commissioners' Treasury Management Advisors undertake reviews of the Minimum Revenue Provision. These reviews have enabled clients to unlock material savings that are then reinvested into service provision. These reviews have also identified significant benefits to General Fund balances through a review of previous financing decisions as well as year-on-year savings through a change to existing MRP policies.

Elizabeth Hall
Treasurer

Appendix A

PRUDENTIAL INDICATORS – WEST MERCIA

1. AFFORDABILITY PRUDENTIAL INDICATORS	2015/16 Estimate	2015/16 Actual	Achieved
	£'000	£'000	
Capital Expenditure	13,166	10,899	
	%	%	
Ratio of financing costs to net revenue stream	1.12	0.83	Yes
	£'000	£'000	
In Year borrowing requirement			
- in year borrowing requirement	13,587	0	Yes
	£'000	£'000	
In year Capital Financing Requirement	12,646	(1,613)	Yes
	£'000	£'000	
Capital Financing Requirement 31 March 2016	46,537	32,210	Yes
	£	£	
Affordable Borrowing Limit			
Increase per council tax payer	£1.20	(£0.15)	Yes
2. TREASURY MANAGEMENT PRUDENTIAL INDICATORS	2015/16 Estimate	2015/16 Actual	Achieved
Authorised limit for external debt	£'000	£'000	
- Borrowing	40,000	10,000	Yes
Operational boundary for external debt	£'000	£'000	
- Borrowing	35,000	10,000	Yes
Upper limit for fixed rate interest exposure			
- net principal re fixed rate borrowing / investments	£40m	£10m	Yes
Upper limit for variable rate exposure			
- net principal re variable rate borrowing / investments	£5m	£0m	Yes

There was no new fixed rate borrowing in 2015/16.

PRUDENTIAL INDICATORS – WARWICKSHIRE

1. AFFORDABILITY PRUDENTIAL INDICATORS	2015/16 Estimate	2015/16 Actual	Achieved
	£'000	£'000	
Capital Expenditure	6,354	5,538	
	%	%	
Ratio of financing costs to net revenue stream	2.44	2.22	Yes
	£'000	£'000	
In Year borrowing requirement			
- in year borrowing requirement	5,728	0	Yes
	£'000	£'000	
In year Capital Financing Requirement	5,728	(476)	Yes
	£'000	£'000	
Capital Financing Requirement 31 March 2016	28,406	21,843	Yes
	£	£	
Affordable Borrowing Limit			
Increase per council tax payer	£1.25	(£0.07)	Yes
2. TREASURY MANAGEMENT PRUDENTIAL INDICATORS	2015/16 Estimate	2015/16 Actual	Achieved
Authorised limit for external debt	£'000	£'000	
- Borrowing	40,000	15,838	Yes
Operational boundary for external debt	£'000	£'000	
- Borrowing	30,000	15,838	Yes
Upper limit for fixed rate interest exposure			
- net principal re fixed rate borrowing / investments	£40m	£15.8m	Yes
Upper limit for variable rate exposure			
- net principal re variable rate borrowing / investments	£5m	£0m	Yes

There was no new fixed rate borrowing in 2015/16.