Joint Audit and Standards Committee

Warwickshire
Police and Crime Commissioner
Treasury Management Outturn Report 2018/2019

Recommendation

The Committee is asked to consider and comment on the Treasury Management Outturn Report for 2018/2019 before its consideration by the Warwickshire Police and Crime Commissioner.

1. Introduction

1.1 Warwickshire Police and Crime Commissioner fully complies 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 their 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 Commissioner approved a Treasury Management Strategy for 2018/2019..

2 External Context

2.1 Economic background: After spiking at over $85/barrel in October 2018, oil prices fell back sharply by the end of the year, declining to just over $50 in late December before steadily climbing toward $70 in April 2019. UK Consumer Price Inflation (CPI) for February 2019 was up 1.9% year/year, just above the consensus forecast but broadly in line with the Bank of England's February Inflation Report. The most recent labour market data for the three months to January 2019 showed the unemployment rate fell to a new low 3.9% while the employment rate of 76.1% was the highest on record. The 3-month average annual growth rate for pay excluding bonuses was 3.4% as wages continue to rise steadily and provide some upward pressure on general inflation. Once adjusted for inflation, real wages were up 1.4%.

After rising to 0.6% in the third calendar quarter from 0.4% in the second, fourth quarter economic growth slowed to 0.2% as weaker expansion in production, construction and services dragged on overall activity. Annual GDP growth at 1.4% continues to remain below trend. Following the Bank of England's decision to increase Bank Rate to 0.75% in August, no changes to monetary policy have been made since.

The US Federal Reserve continued its tightening bias throughout 2018, pushing rates to the 2.25%-2.50% range in December. However, a recent softening in US data caused the Fed to signal a pause in hiking interest rates at the last Federal Open Market Committee (FOMC) meeting in March.

With the 29th March 2019, the original EU 'exit day' now been and gone, having failed to pass a number of meaningful votes in Parliament, including shooting down Theresa May's deal for the third time, MPs voted by a majority of one (313 to 312) to force the prime minister to ask for an extension to the Brexit process beyond 12th April in order to avoid a no-deal scenario. Recent talks between the Conservative and Labour parties to try to reach common ground on a deal which may pass a vote by MPs have yet to yield any positive results. The EU must grant any extension and its leaders have been clear that the terms of the deal are not up for further negotiation. The ongoing uncertainty continues to weigh on sterling and UK markets.

While the domestic focus has been on Brexit's potential impact on the UK economy, globally the first quarter of 2019 has been overshadowed by a gathering level of broader based economic uncertainty. The US continues to be set on a path of protectionist trade policies and tensions with China in particular, but with the potential for this to spill over into wider trade relationships, most notably with EU. The EU itself appeared to be show signs of a rapid slowdown in economic growth with the major engines of its economy, Germany and France, both suffering misfires from downturns in manufacturing alongside continued domestic/populist unrest in France. The International Monetary Fund downgraded its forecasts for global economic growth in 2019 and beyond as a consequence.

2.1 **Financial markets:**

December was a month to forget in terms of performance of riskier asset classes, most notably equities. The FTSE 100 (a good indicator of global corporate sentiment) returned -8.8% assuming dividends were reinvested; in pure price terms it fell around 13%. However, since the beginning of 2019 markets have rallied, and the FTSE 100 and FTSE All share indices were both around 10% higher than at the end of

2018.

Gilt yields continued to display significant volatility over the period on the back of ongoing economic and political uncertainty in the UK and Europe. After rising in October, gilts regained their safe-haven status throughout December and into the new year - the 5-year benchmark gilt yield fell as low as 0.80% and there were similar falls in the 10-year and 20-year gilts over the same period dropping from 1.73% to 1.08% and from 1.90% to 1.55%. The increase in Bank Rate pushed up money markets rates over the year and 1-month, 3-month and 12-month LIBID (London Interbank Bid) rates averaged 0.53%, 0.67% and 0.94% respectively over the period.

Recent activity in the bond markets and PWLB interest rates highlight that weaker economic growth is not just a UK phenomenon but a global risk. During March the US yield curve inverted (10-year Treasury yields were lower than US 3 month money market rates) and German 10-year Bund yields turned negative. The drivers are a significant shift in global economic growth prospects and subsequent official interest rate expectations given its impact on inflation expectations. Further to this is world trade growth which collapsed at the end of 2018 falling by 1.8% year-on-year. A large proportion of this downturn in trade can be ascribed to the ongoing trade tensions between the US and China which despite some moderation in January does suggest that the International Monetary Fund's (IMF) and Organisation for Economic Co-Operation & Development's (OECD) forecasts for global growth in 2019 of 3.5% might need to be revised downwards.

2.3 Credit background:

Credit Default Swap (CDS) spreads drifted up towards the end of 2018 on the back of Brexit uncertainty before declining again in 2019 and continuing to remain low in historical terms. After hitting around 129 basis points in December 2018, the spread on non-ringfenced bank NatWest Markets plc fell back to around 96bps at the end of March, while for the ringfenced entity, National Westminster Bank plc, the CDS spread held relatively steady around 40bps. The other main UK banks, as yet not separated into ringfenced and non-ringfenced from a CDS perspective, traded between 33 and 79bps at the end of the period.

The ringfencing of the big four UK banks (Barclays, Bank of Scotland/Lloyds, HSBC and RBS/Natwest Bank plc) transferred their business lines into retail (ringfenced) and investment banking (non-ringfenced) entities.

In February, Fitch put the UK AA sovereign long-term rating on Rating

Watch Negative as a result of Brexit uncertainty, following this move with the same treatment for UK banks and a number of government-related entities.

There were minimal other credit rating changes during the period. Moody's revised the outlook on Santander UK to positive from stable to reflect the bank's expected issuance plans which will provide additional protection for the its senior unsecured debt and deposits.

3 The Police and Crime Commissioner Current Treasury Position

3.1 The Police and Crime Commissioner raises long-term borrowing to fund capital expenditure, i.e., expenditure on land, buildings and equipment. The Police and Crime Commissioner did not take any new borrowing in 2018/2019 There was £13.5 m of long-term borrowing as at 31st March 2019

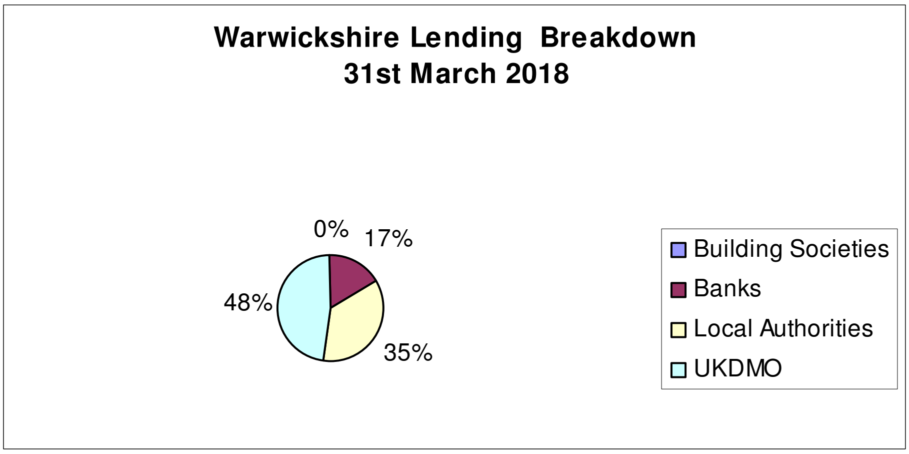
3.2 At the same time as borrowing for capital purposes, the Police and Crime Commissioner also has a investment portfolio. This consists of the Police and Crime Commissioner's reserves and short-term cash flows. This cash was invested in-house.

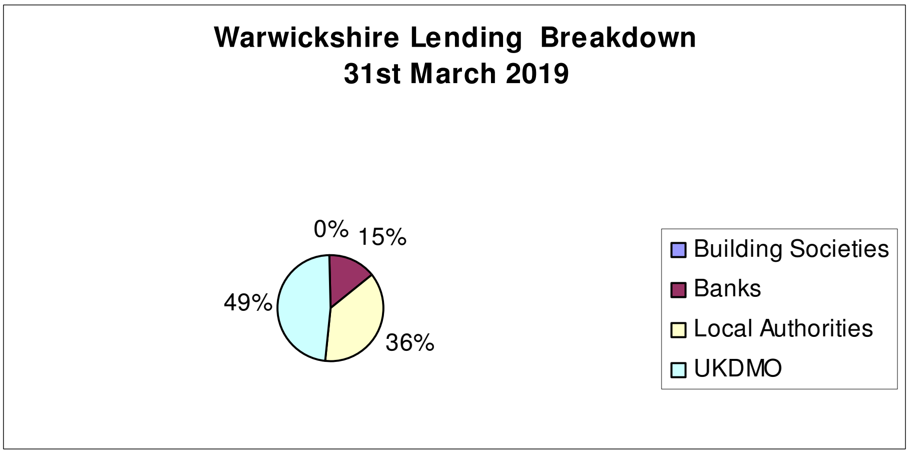
3.3 As at 31 March 2018, the Police and Crime Commissioner for Warwickshire had £11.4m of cash investments and this has reduced to £13.7m by 31 March 2019. Table 1.1 shows the Police and Crime Commissioner's debt and investment position at the beginning and the end of the year was as follows:

Table 1: Summary of Treasury Position for Warwickshire at 31 March 18

	Principal at 31.03.18	**Rate/ Return For 17/18**	**Principal at 31.03.19**	**Rate/ Return for 18/19**
A: Fixed Rate Funding	£m	%	£m	%
Public Works Loans Board Debt	14.0	4.68	13.5	5.02
Total Debt	**14.0**	**4.68**	**13.5**	**5.02**
B: Investments				
In House	11.4	0.25	13.7	0.51

Total Investments	**11.4**	**0.25**	**13.7**	**0.51**





4 Treasury Management Strategy for 2018/2019

4.1 The Police and Crime Commissioner approved the Treasury Strategy for 2018/2019 in April 2018.

5 Borrowing Outturn for 2018/2019

5.1 Due to the slippage in the capital programme, the Police and Crime Commissioners did not take any PWLB borrowing in 2018/2019. The £1.7m of capital spend was funded mainly from internal borrowing (£0.9m) and capital grant (£0.4m). Borrowing costs for Warwickshire were £0.644m compared to a budget of £0.645m. The 2018/2019 budget has been increased to reflect possible external borrowing that may be required later in 2019/20. 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 2018/2019 and the results for the year are shown in **Appendix A.**

7 Investment Rates 2018/2019

7.1 The Bank of England Base Rate increased the rate to 0.75% on 2nd August 2018

8 Investment Outturn for 2018/2019

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 April 18 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 Commissioner manages their short-term cash balances in-house and invest with the institutions listed in the Police and Crime Commissioner's approved lending list. In 2018/2019 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 2018/2019

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Table 3: Investment Outturn 2018/2019

	Average balance of Investments £m	Rate of Return %	Benchmark Return %
Internally Managed - Warwickshire	15	0.51	0.40

8.3 Investment income for Warwickshire was £76k compared to a budget of £23k.

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 2018/2019

9.1 No debt rescheduling was undertaken in 2018/2019

10.0 Approved Limits

Approved Limits for Warwickshire

During 2018/2018 there was 1 breach of the limits set within the Treasury Management strategy. This was with Lloyds Bank, this was corrected within 24 hours. It arose due to ICT issues

Approved Counterparty Limits for Warwickshire

During 2018/2019 there were no breaches of the approved counterparty list or limits set within the Treasury Management strategy

11.0 Investment Limits

The investment limits for individual organisations or groups of organisations are shown below.

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

All investments for Warwickshire were madewithin the limits set by the Treasury Management Strategy. There were no breaches reported during 2018/2019

12.0 Treasury Management Indicators

By 2018/2019 the Commissioner measured and managed their exposure to treasury management risks using Treasury Management indicators governing upper limits for fixed and variable rate exposure

Security

The Commissioners measure of their exposure to credit risk by monitoring the value weighted average credit rating/credit score of their investment portfolios. Shown in the table below.

	Target
Portfolio average credit rating for Warwickshire	A+

	Achieved
Portfolio average credit rating for Warwickshire	AA

Liquidity

By 2018/2019 the Commissioners measured and managed their exposure to treasury management risks using Treasury Management indicators governing upper limits for fixed and variable rate exposure

	Target
Total Cash Available for 3 months for Warwickshire	£21.7m

	Achieved
Total Cash Available for 3 months for Warwickshire	£21.7m

Principal Sums Invested for Periods Longer than 364 days

The purpose of this indicator was 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 were:-

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

	Achieved
Limit on principal invested beyond the year end for Warwickshire	£5m

Elizabeth Hall
Treasurer

Appendix A

PRUDENTIAL INDICATORS – WARWICKSHIRE

1. AFFORDABILITY PRUDENTIAL INDICATORS	2018/2019 Estimate	2018/2019 Actual	Achieved
	£'000	**£'000**	
Capital Expenditure	7,912	1,668	
	%	**%**	
Ratio of financing costs to net revenue stream	1.62	1.56	Yes
	£'000	**£'000**	
In Year borrowing requirement			
- in year borrowing requirement	3,033	0	Yes
	£'000	**£'000**	
In year Capital Financing Requirement	3,109	15	Yes
	£'000	**£'000**	
Capital Financing Requirement 31 March 2019	28,993	25,029	Yes
	£	**£**	
Affordable Borrowing Limit			
Increase per council tax payer	£0.59	£0.71	Yes
2. TREASURY MANAGEMENT PRUDENTIAL INDICATORS	**2018/2019 Estimate**	**2018/2019 Actual**	**Achieved**
Authorised limit for external debt	**£'000**	**£'000**	
- Borrowing	40,000	13,549	Yes
Operational boundary for external debt	**£'000**	**£'000**	
- Borrowing	30,000	13,549	Yes
Upper limit for fixed rate interest exposure			
- net principal re fixed rate borrowing / investments	£40m	£13.5m	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 2018/2019

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