Joint Audit and Standards Committee

5th July 2021

West Mercia
Police and Crime Commissioner

Treasury Management Outturn Report 2020/2021

Recommendation

The Committee is asked to consider and comment on the Treasury Management Outturn Report for 2020/2021 before its consideration by the West Mercia Police and Crime Commissioner.

1. Introduction

1.1 West Mercia 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 2020/21.

2 External Context

Economic background: The coronavirus pandemic dominated 2020/21, leading to almost the entire planet being in some form of lockdown during the year. The start of the financial year saw many central banks cutting interest rates as lockdowns caused economic activity to grind to a halt. The Bank of England cut Bank Rate to 0.1% and the UK government provided a range of fiscal stimulus measures, the size of which has not been seen in peacetime.

Some good news came in December 2020 as two COVID-19 vaccines were given approval by the UK Medicines and Healthcare products Regulatory Agency (MHRA). The UK vaccine rollout started in earnest;

over 31 million people had received their first dose by 31st March.
A Brexit trade deal was agreed with only days to spare before the 11pm 31st December 2020 deadline having been agreed with the European Union on Christmas Eve.

The Bank of England (BoE) held Bank Rate at 0.1% throughout the year but extended its Quantitative Easing programme by £150 billion to £895 billion at its November 2020 meeting. In its March 2021 interest rate announcement, the BoE noted that while GDP would remain low in the near-term due to COVID-19 lockdown restrictions, the easing of these measures means growth is expected to recover strongly later in the year. Inflation is forecast to increase in the near-term and while the economic outlook has improved there are downside risks to the forecast, including from unemployment which is still predicted to rise when the furlough scheme is eventually withdrawn.

Government initiatives supported the economy and the Chancellor announced in the 2021 Budget a further extension to the furlough (Coronavirus Job Retention) scheme until September 2021. Access to support grants was also widened, enabling more self-employed people to be eligible for government help. Since March 2020, the government schemes have help protect more than 11 million jobs.

Despite the furlough scheme, unemployment still rose. Labour market data showed that in the three months to January 2021 the unemployment rate was 5.0%, in contrast to 3.9% recorded for the same period 12 months ago. Wages rose 4.8% for total pay in nominal terms (4.2% for regular pay) and was up 3.9% in real terms (3.4% for regular pay). Unemployment is still expected to increase once the various government job support schemes come to an end.

Inflation has remained low over the 12 month period. Latest figures showed the annual headline rate of UK Consumer Price Inflation (CPI) fell to 0.4% year/year in February, below expectations (0.8%) and still well below the Bank of England's 2% target. The ONS's preferred measure of CPIH which includes owner-occupied housing was 0.7% year/year (1.0% expected).

After contracting sharply in Q2 (Apr-Jun) 2020 by 19.8% q/q, growth in Q3 and Q4 bounced back by 15.5% and 1.3% respectively. The easing of some lockdown measures in the last quarter of the calendar year enabled construction output to continue, albeit at a much slower pace than the 41.7% rise in the prior quarter. When released, figures for Q1 (Jan-Mar) 2021 are expected to show a decline given the national lockdown.

After collapsing at an annualised rate of 31.4% in Q2, the US economy rebounded by 33.4% in Q3 and then a further 4.1% in Q4. The US recovery has been fuelled by three major pandemic relief stimulus packages totalling over $5 trillion. The Federal Reserve cut its main interest rate to between 0% and 0.25% in March 2020 in response to the pandemic and it has remained at the same level since. Joe Biden became the 46th US president after defeating Donald Trump.

The European Central Bank maintained its base rate at 0% and deposit rate at -0.5% but in December 2020 increased the size of its asset purchase scheme to €1.85 trillion and extended it until March 2022.

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2.1 **Financial markets:**

Monetary and fiscal stimulus helped provide support for equity markets which rose over the period, with the Dow Jones beating its pre-crisis peak on the back of outperformance by a small number of technology stocks. The FTSE indices performed reasonably well during the period April to November, before being buoyed in December by both the vaccine approval and Brexit deal, which helped give a boost to both the more internationally focused FTSE 100 and the more UK-focused FTSE 250, however they remain lower than their pre-pandemic levels.

Ultra-low interest rates prevailed throughout most of the period, with yields generally falling between April and December 2020. From early in 2021 the improved economic outlook due to the new various stimulus packages (particularly in the US), together with the approval and successful rollout of vaccines, caused government bonds to sell off sharply on the back of expected higher inflation and increased uncertainty, pushing yields higher more quickly than had been anticipated.

The 5-year UK benchmark gilt yield began the financial year at 0.18% before declining to -0.03% at the end of 2020 and then rising strongly to 0.39% by the end of the financial year. Over the same period the 10-year gilt yield fell from 0.31% to 0.19% before rising to 0.84%. The 20-year declined slightly from 0.70% to 0.68% before increasing to 1.36%. 1-month, 3-month and 12-month SONIA bid rates averaged 0.01%, 0.10% and 0.23% respectively over the financial year.

The yield on 2-year US treasuries was 0.16% at the end of the period, up from 0.12% at the beginning of January but down from 0.21% at the start of the financial year. For 10-year treasuries the end of period yield was 1.75%, up from both the beginning of 2021 (0.91%) and the start of the financial year (0.58%).

2.3 Credit background:

After spiking in March 2020, credit default swap spreads declined over the remaining period of the year to broadly pre-pandemic levels. The gap in spreads between UK ringfenced and non-ringfenced entities remained, albeit Santander UK is still an outlier compared to the other ringfenced/retail banks. At the end of the period Santander UK was trading the highest at 57bps and Standard Chartered the lowest at

32bps. The other ringfenced banks were trading around 33 and 34bps while Nationwide Building Society was 43bps.

Credit rating actions to the period ending September 2020 have been covered in previous outturn reports. Subsequent credit developments include Moody's downgrading the UK sovereign rating to Aa3 with a stable outlook which then impacted a number of other UK institutions, banks and local government. In the last quarter of the financial year S&P upgraded Clydesdale Bank to A- and revised Barclay's outlook to stable (from negative) while Moody's downgraded HSBC's Baseline Credit Assessment to baa3 whilst affirming the long-term rating at A1.

The vaccine approval and subsequent rollout programme are both credit positive for the financial services sector in general, but there remains much uncertainty around the extent of the losses banks and building societies will suffer due to the economic slowdown which has resulted due to pandemic-related lockdowns and restrictions. The institutions and durations on the Authority's counterparty list recommended by treasury management advisors Arlingclose remain under constant review, but at the end of the period no changes had been made to the names on the list or the recommended maximum duration of 35 days.

3 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 took £16m of new PWLB borrowing in 2020/2021, this being a £10m Annuity Loan for 15 years at a rate of 0.98% and a further £6m EIP Loan for 10 years at a rate of 1.21%. In addition £10m of short-term borrowing was taken to replace the maturity of the short-term borrowing from 2019/20 (both from local Authorities). There was £45.8m of borrowing as at 31st March 2021.

3.2 At the same time as borrowing for capital purposes, the Police and Crime Commissioner also has an 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 2020, the Police and Crime Commissioner for West Mercia had £8.8m of cash investments and this had increased to £9.9m by 31 March 2021, mainly due to slippage on the capital programme. 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 at 31 March 2021

	Principal at 31.03.20	Rate/ Return For 19/20	Principal at 31.03.21	Rate/ Return for 20/21
A: Fixed Rate Funding	£m	%	£m	%
Public Works Loans Board Debt	20.00	3.15	35.8	2.22
Local Authority Borrowing	**10.00**	**0.95**	**10.0**	**0.30**
Total Debt	**30.00**	**2.39**	**45.8**	**1.79**
B: Investments				
In House	8.8	0.50	9.9	0.085
Total Investments	**8.8**	**0.50**	**9.9**	**0.085**

4 Treasury Management Strategy for 2020/2021

4.1 The Police and Crime Commissioner approved the Treasury Strategy for 2020/2021 in February 2020.

5 Borrowing Outturn for 2020/21

5.1 During 2020/21, the Police and Crime Commissioner took out temporary short-term borrowing from Local Authorities in the first quarter to cover temporary cash flow deficits and then £10m in September 2020 to spread the maturity profile of the longer-term debt. Long-term borrowing with the Public Works Loans Board (PWLB) of £10m was taken out in December 2020 and £6m was taken out in March 2021 to fund the capital programme and “externalise” the internal borrowing from prior to 2019/20.

The £12.9m of capital spend during the year was mainly funded from borrowing (£11.2m). Borrowing costs for West Mercia were £0.727m compared to a budget of £1.154m. 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 2020/2021 and the results for the year are shown in **Appendix A.**

7 Investment Rates 2020/21

7.1 The Bank of England Base Rate remained at its historic lowest level of 0.10% throughout 2020/21.

8 Investment Outturn for 2020/2021

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 February 2020. 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 2020/21 the Police and Crime Commissioners have invested for a range of periods from overnight to 6 months, 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 2020/21

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Table 3: Investment Outturn 2020/21

	Average balance of Investments £m	Rate of Return %	Benchmark Return %
Internally Managed - West Mercia	7.7	0.085	0.1

8.3 Investment income for West Mercia was £7k compared to a budget of £20k. Due to the low base rate, investment returns have been very low throughout the year, with surplus cash being invested at 0% on many occasions. Investment rates on offer from the government have been negative at times and this resulted in higher balances being held with HSBC than would normally have been the case.

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 2020/21

9.1 No debt rescheduling was undertaken in 2020/21

10.0 Approved Limits

Approved Limits for West Mercia

During 2020/21 there were four breaches of the limits set within the Treasury Management strategy, all being with HSBC. This was due to being unable to invest surplus funds in other institutions due to negative interest rates (UK government), periods of investment only being short-term (one or two weeks), or lack of offers from Local Authorities. The short-term limit for HSBC has now been increased from £7m to £10m, as set out in the Treasury Management Strategy Report for 2020/21.

Approved Counterparty Limits for West Mercia

During 2020/2021 there were no other breaches of the approved counterparty list or limits set within the Treasury Management strategy, except as mentioned above in respect of HSBC.

11.0 Investment Limits

The investment limits for individual organisations or groups of organisations that applied in the year are shown below.

	West Mercia Cash Limit
Any single organisation, except the UK Central Government	£2m
UK Central Government	Unlimited
Any group of organisations under the same ownership	£2m per group
Registered Providers (Housing Associations)	£6m
Unsecured Investments with Building Societies	£6m
Money Market Funds	£6m
Force Banking Provider HSBC	£7m

12.0 Treasury Management Indicators

The Commissioner measures and manages his exposure to treasury management risks using Treasury Management indicators governing upper limits for fixed and variable rate exposure

Security

The Commissioner measures 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 West Mercia	A-

	Achieved
Portfolio average credit rating for West Mercia	AA-

Liquidity

The Commissioner will continue to adopt a voluntary measure of his exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments within a rolling one month period without additional borrowing.

	Target
Total Cash Available for 3 months for West Mercia	£21.7m

	Achieved
Total Cash Available for 3 months for West Mercia	£14.0m

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 West Mercia	£5m

	Achieved
Actual principal invested beyond the year end for West Mercia	£1m

Elizabeth Hall
Treasurer

Appendix A

PRUDENTIAL INDICATORS – WEST MERCIA

1. AFFORDABILITY PRUDENTIAL INDICATORS	2020/21 Estimate	2020/21 Actual	Achieved
	£'000	**£'000**	
Capital Expenditure	17,011	12,995	
	%	**%**	
Ratio of financing costs to net revenue stream	1.45	1.31	Yes
	£'000	**£'000**	
In Year borrowing requirement			
- in year borrowing requirement	15,470	11,220	Yes
	£'000	**£'000**	
In year Capital Financing Requirement	13,248	8,885	Yes
	£'000	**£'000**	
Capital Financing Requirement 31 March 2021	66,493	57,865	Yes
	£	**£**	
Affordable Borrowing Limit			
Increase per council tax payer	£0.95	£0.58	Yes
2. TREASURY MANAGEMENT PRUDENTIAL INDICATORS	**2020/21 Estimate**	**2020/21 Actual**	**Achieved**
Authorised limit for external debt	**£'000**	**£'000**	
- Borrowing	80,000	45,778	Yes
Operational boundary for external debt	**£'000**	**£'000**	
- Borrowing	70,000	45,778	Yes
Upper limit for fixed rate interest exposure			
- net principal re fixed rate borrowing / investments	£80m	£45.8m	Yes
Upper limit for variable rate exposure			
- net principal re variable rate borrowing / investments	£5m	£0m	Yes