Cambridgeshire
Police & Crime
Commissioner

Annual Treasury Management Review
2014/15

Sept 2015

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1. Introduction

This Commissioner is required by regulations issued under the Local Government Act 2003 to produce an annual treasury management review of activities and the actual prudential and treasury indicators for 2014/15. This report meets the requirements of both the CIPFA Code of Practice on Treasury Management (the Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

During 2014/15 the minimum reporting requirements were that the Commissioner should receive the following reports:

- an annual treasury strategy in advance of the year
- a mid-year (minimum) treasury update report
- an annual review following the end of the year describing the activity compared to the strategy (this report)

In addition, the Finance Sub Group of the Business Coordination Board will receive monthly cash flow forecasts.

The regulatory environment places responsibility on members for the review and scrutiny of treasury management policy and activities. This report is therefore important in that respect, as it provides details of the outturn position for treasury activities and highlights compliance with the Constabulary's policies previously approved by the Commissioner.

The Commissioner also confirms that it has complied with the requirements under the Code to give prior scrutiny to all of the above treasury management reports by the Joint Audit Committee before they were reported to the full Commissioner.

2. Prudential and treasury indicators

During 2014/15, the Commissioner complied with its legislative and regulatory requirements. The key actual prudential and treasury indicators detailing the impact of capital expenditure activities during the year, with comparators, are as follows:

Actual prudential and treasury indicators	2013/14 Actual £000	2014/15 Original £000	2014/15 Actual £000
Capital expenditure • Total	4,559	4,645	5,634
Capital Financing Requirement: • Total	25,275	24,434	24,434
Gross borrowing	10,602	10,191	10,191
External debt	10,602	10,191	10,191
Investments • Under 1 year • Total	13,057	9,028	14,928
Net borrowing	(2,455)	(1,163)	(4,737)

Gross borrowing and the CFR - in order to ensure that borrowing levels are prudent over the medium term and only for a capital purpose, the Commissioner should ensure that its gross external borrowing does not, except in the short term, exceed the total of the capital financing requirement in the preceding year (2014/15) plus the estimates of any additional capital financing requirement for the current (2015/16) and next two financial years. This essentially means that the Commissioner is not borrowing to support revenue expenditure. This indicator allows the Commissioner some flexibility to borrow in advance of its immediate capital needs in 2015/16

3. Overall Treasury Position as at 31 March 2015

At the beginning and the end of 2014/15 the Commissioner's treasury (excluding borrowing by PFI and finance leases) position was as follows:

TABLE 1	31 March 2014 Principal	Rate/ Return	Average Life yrs		31 March 2015 Principal	Rate/ Return	Average Life yrs
Total debt	***£10.6m***	***4.625%***	***17***		***£10.2m***	***4.625%***	***16.04***
CFR	***£25.3m***				***£24.4m***		
Over / (under) borrowing	***£(14.7) m***				***£(14.2)m***		
Total investments	***£13.06m***	***0.41%***			***£14.1m***	***0.43%***	
Net debt	**£(2.4)m**				**£(3.9)m**		

4. The Strategy for 2014/15

The expectation for interest rates within the strategy for 2014/15 anticipated low but rising Bank Rate (starting in quarter 1 of 2015), and gradual rises in medium and longer term fixed borrowing rates during 2014/15. Variable, or short-term rates, were expected to be the cheaper form of borrowing over the period. Continued uncertainty in the aftermath of the 2008 financial crisis promoted a cautious approach, whereby investments would continue to be dominated by low counterparty risk considerations, resulting in relatively low returns compared to borrowing rates.

In this scenario, the treasury strategy was to postpone borrowing to avoid the cost of holding higher levels of investments and to reduce counterparty risk.

The actual movement in gilt yields meant that PWLB rates saw little overall change during the first four months of the year but there was then a downward trend for the rest of the year with a partial reversal during February.

5. The Borrowing Requirement and Debt

The Commissioner's underlying need to borrow to finance capital expenditure is termed the Capital Financing Requirement (CFR).

	31 March 2014 Actual	31 March 2015 Budget	31 March 2015 Actual
CFR General Fund (£m)	25.3m	24.4m	24.4m
Total CFR	25.3m	24.4m	24.4m

The authorised limit - the authorised limit is the "affordable borrowing limit" required by s3 of the Local Government Act 2003. Once this has been set, the Commissioner does not have the power to borrow above this level. The table below demonstrates that during 2014/15 the Commissioner has maintained gross borrowing within its authorised limit.

The operational boundary – the operational boundary is the expected borrowing position of the Commissioner during the year. Periods where the actual position is either below or over the boundary is acceptable subject to the authorised limit not being breached.

Actual financing costs as a proportion of net revenue stream - this indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream.

	2014/15
Authorised limit	£14.8m
Maximum gross borrowing position	£10.6m
Operational boundary	£11.8m
Average gross borrowing position	£10.40m
Financing costs as a proportion of net revenue stream	0.94%

The maturity structure of the debt portfolio was as follows:

	31 March 2014 actual	2014/15 original limits	31 March 2015 actual
Under 12 months	£0.4m	£0.4m	£0.4m
12 months and within 24 months	£0.4m	£0.4m	£0.4m
24 months and within 5 years	£1.4m	£1.4m	£1.4m
5 years and within 10 years	£2.8m	£2.7m	£2.7m
10 years and within 20 years	£6.5m	£5.8m	£5.8m

The maturity structure of the investment portfolio was as follows:

All investments were for under one year

The exposure to fixed and variable rates was as follows:

	31 March 2014 Actual	2014/15 Original Limits	31 March 2015 Actual
Fixed rate (principal or interest) based on net debt	£10.6m	£10.2m	£10.2m
Variable rate (principal or interest) based on net debt	0	0	0
Limits on fixed interest rates based on net debt: • Debt only • Investments only	£25.3m	£ 24.4m	£ 24.4m

Limits on variable interest rates: • Debt only • Investments only	£6.3m	£6.1m	£6.1m

The Economy and Interest Rates

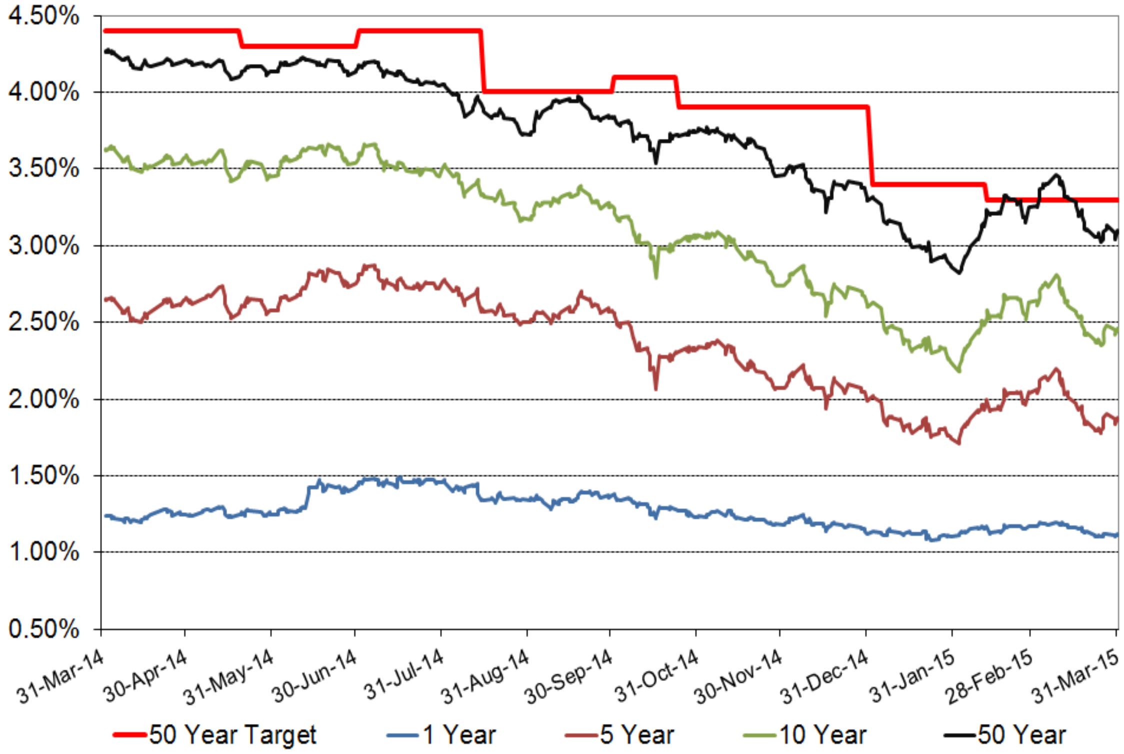
The original market expectation at the beginning of 2014/15 was for the first increase in Bank Rate to occur in quarter 1 2015 as the unemployment rate had fallen much faster than expected through the Bank of England's initial forward guidance target of 7%. In May, however, the Bank revised its forward guidance. A combination of very weak pay rises and inflation above the rate of pay rises meant that consumer disposable income was still being eroded and in August the Bank halved its forecast for pay inflation in 2014 from 2.5% to 1.25%. Expectations for the first increase in Bank Rate therefore started to recede as growth was still heavily dependent on buoyant consumer demand. During the second half of 2014 financial markets were caught out by a halving of the oil price and the collapse of the peg between the Swiss franc and the euro. Fears also increased considerably that the ECB was going to do too little too late to ward off the threat of deflation and recession in the Eurozone. In mid-October, financial markets had a major panic for about a week. By the end of 2014, it was clear that inflation in the UK was going to head towards zero in 2015 and possibly even turn negative. In turn, this made it clear that the MPC would have great difficulty in starting to raise Bank Rate in 2015 while inflation was around zero and so market expectations for the first increase receded back to around quarter 3 of 2016.

Gilt yields were on a falling trend for much of the last eight months of 2014/15 but were then pulled in different directions by increasing fears after the anti-austerity parties won power in Greece in January; developments since then have increased fears that Greece could be heading for an exit from the euro. While the direct effects of this would be manageable by the EU and ECB, it is very hard to quantify quite what the potential knock on effects would be on other countries in the Eurozone once the so called impossibility of a country leaving the EZ had been disproved. Another downward pressure on gilt yields was the announcement in January that the ECB would start a major programme of quantitative easing, purchasing EZ government and other debt in March. On the other hand, strong growth in the US caused an increase in confidence that the US was well on the way to making a full recovery from the financial crash and would be the first country to start increasing its central rate, probably by the end of 2015. The UK would be closely following it due to strong growth over both 2013 and 2014 and good prospects for a continuation into 2015 and beyond. However, there was also an increase in concerns around political risk from the general election due in May 2015.

6. Borrowing Rates in 2014/15

PWLB borrowing rates - the graph below shows how PWLB certainty rates have fallen to historically very low levels during the year.

Clients who need this graph to be printable in black and white will find an alternative version in Appendix 3

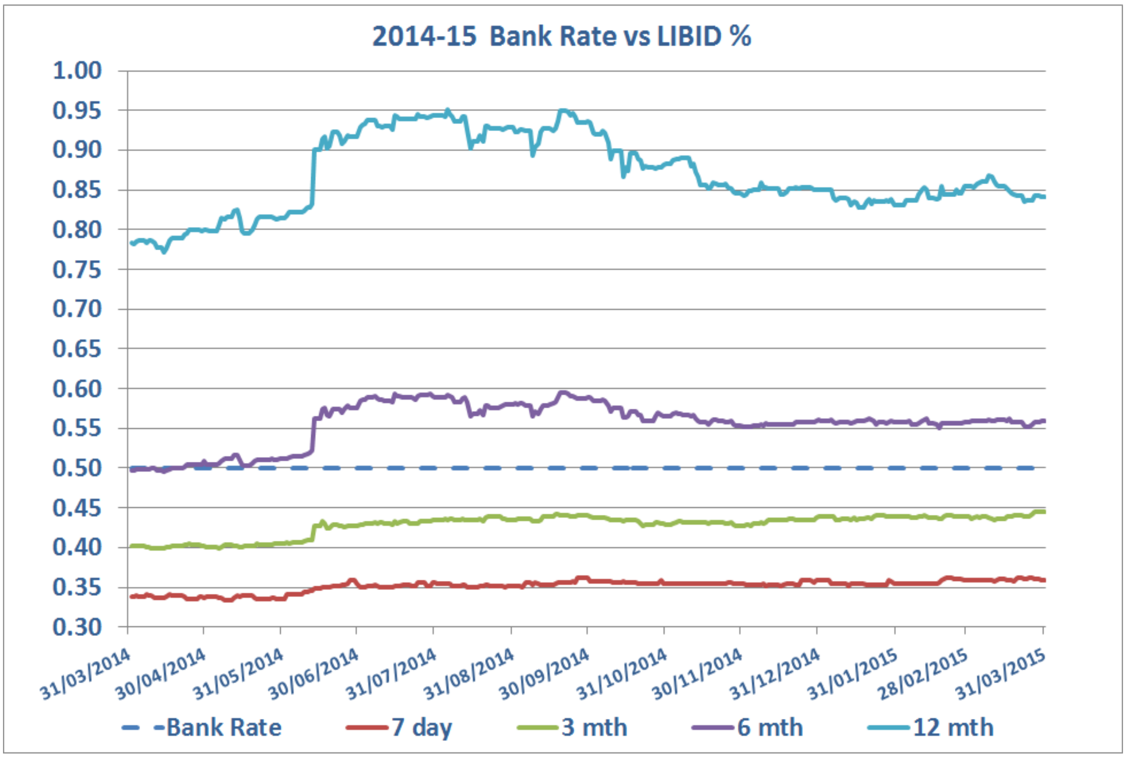


7. Borrowing Outturn for 2014/15

Borrowing
Due to investment concerns, both counterparty risk and low investment returns, no borrowing was undertaken during the year.

8. Investment Rates in 2014/15

Bank Rate remained at its historic low of 0.5% throughout the year; it has now remained unchanged for six years. Market expectations as to the timing of the start of monetary tightening started the year at quarter 1 2015 but then moved back to around quarter 3 2016 by the end of the year. Deposit rates remained depressed during the whole of the year, primarily due to the effects of the Funding for Lending Scheme.



9. Investment Outturn for 2014/15

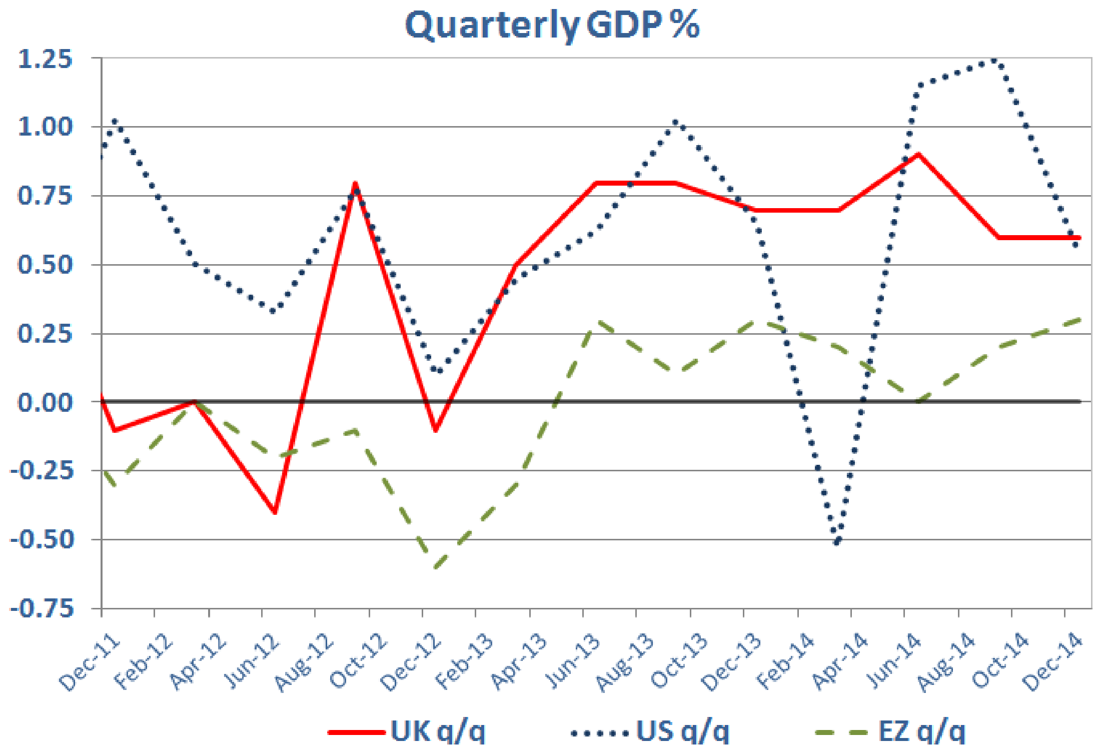
Investment Policy – the Commissioner's investment policy is governed by CLG guidance, which has been implemented in the annual investment strategy approved by the Commissioner on 7th May 2013. This policy sets out the approach for choosing investment counterparties, and is based on credit ratings provided by the three main credit rating agencies supplemented by additional market data (such as rating outlooks, credit default swaps, bank share prices etc.).

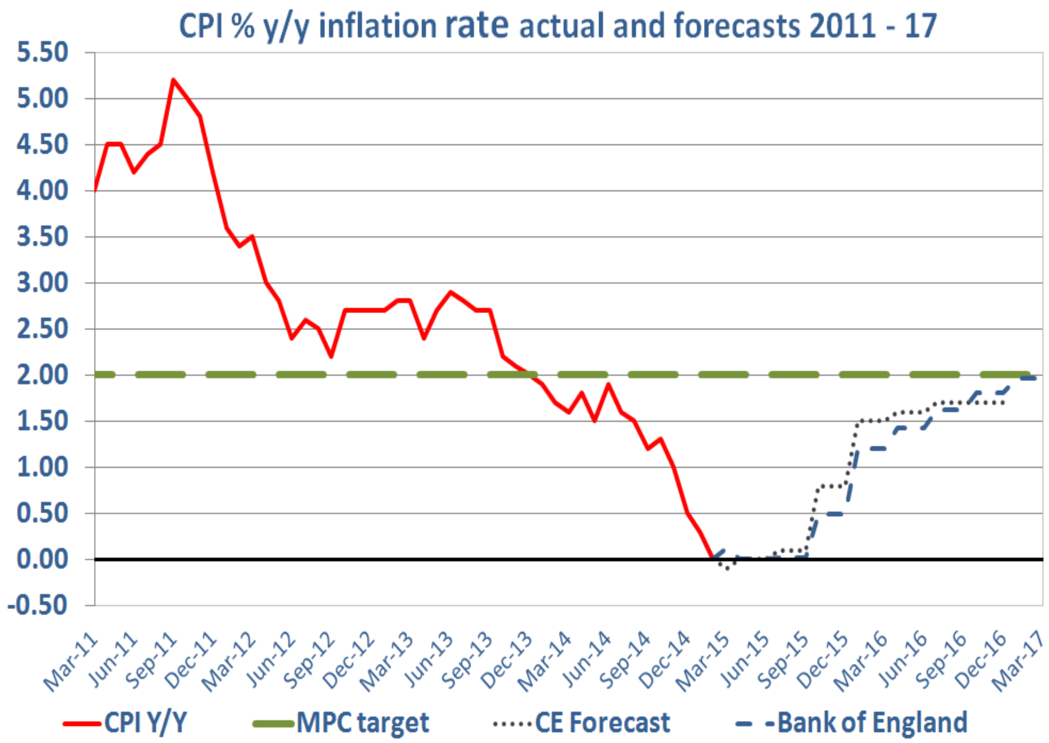
The investment activity during the year conformed to the approved strategy, and the Commissioner had no liquidity difficulties.

Investments held by the Commissioner - the Commissioner maintained an average balance of £18,705,793 of internally managed funds. The internally managed funds earned an average rate of return of 0.43%. The comparable performance indicator is the average overnight LIBID rate which was 0.34519%.

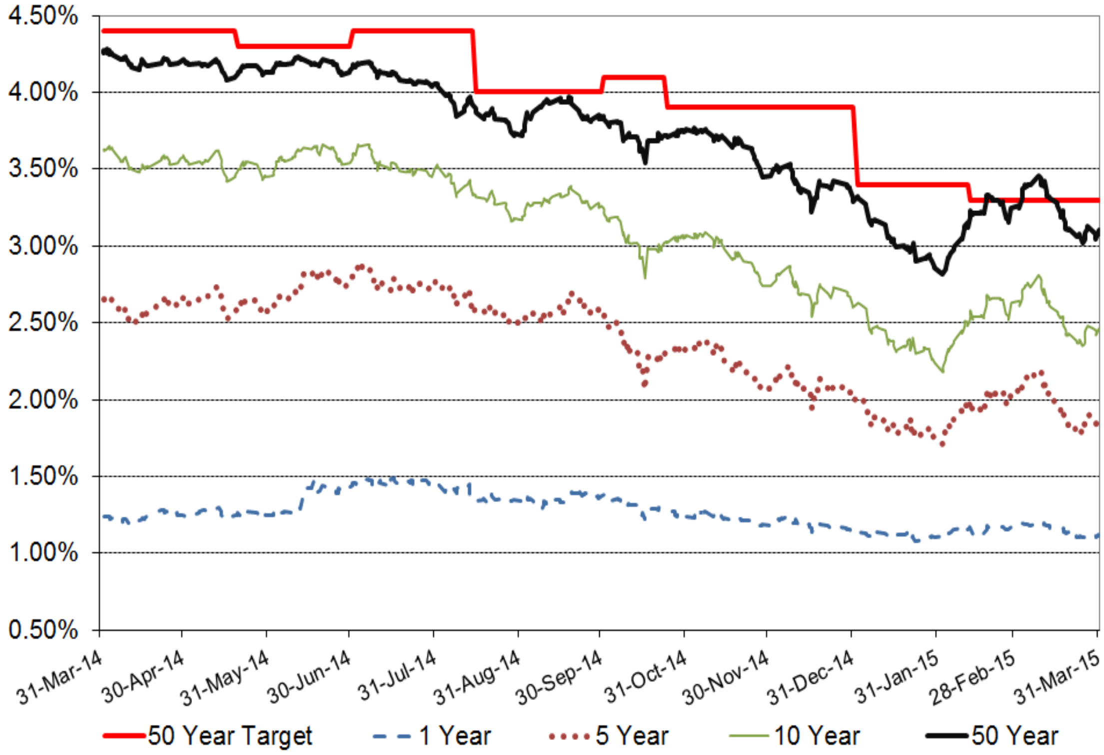
Appendix 3: Graphs

Please find below graphs which clients may wish to use.





The graph below is intended for use by clients who need the graph in paragraph 6 to be printable in black and white.



The graph below is intended for use by clients who need the graph in paragraph 8 to be printable in black and white.