Annual Treasury Management Review
2015/16

Cambridgeshire Police & Crime Commissioner
August 2016

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1. Introduction

The Police & Crime Commissioner (the 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 2015/16. 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 2015/16 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 has received 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 Commissioner's previously approved policies.

This Commissioner confirms that he has complied with the requirement 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 Commissioner.

2. The Economy and Interest Rates

Market expectations for the first increase in Bank Rate moved considerably during 2015/16, starting at quarter 3 2015 but soon moving back to quarter 1 2016. However, by the end of the year, market expectations had moved back radically to quarter 2 2018 due to many fears including concerns that China's economic growth could be heading towards a hard landing; the potential destabilisation of some emerging market countries particularly exposed to the Chinese economic slowdown; and the continuation of the collapse in oil prices during 2015 together with continuing Eurozone growth uncertainties.

These concerns have caused sharp market volatility in equity prices during the year with corresponding impacts on bond prices and bond yields due to safe haven flows. Bank Rate, therefore, remained unchanged at 0.5% for the seventh successive year. Economic growth (GDP) in 2015/16 has been disappointing with growth falling steadily from an annual rate of 2.9% in quarter 1 2015 to 2.1% in quarter 4.

The sharp volatility in equity markets during the year was reflected in sharp volatility in bond yields. However, the overall dominant trend in bond yields since July 2015 has been for yields to fall to historically low levels as forecasts for inflation have repeatedly been revised downwards and expectations of increases in central rates have been pushed back. In addition, a notable trend in the year was that several central banks introduced negative interest rates as a measure to stimulate the creation of credit and hence economic growth.

The ECB commenced a full blown quantitative easing programme of purchases of Eurozone government and other bonds starting in March at €60bn per month. This put downward pressure on Eurozone bond yields. There was a further increase in this programme of QE in December 2015.

As for America, the economy has continued to grow healthily on the back of resilient consumer demand. The first increase in the central rate occurred in December 2015 since when there has been a return to caution as to the speed of further increases due to concerns around the risks to world growth.

The UK elected a majority Conservative Government in May 2015, removing one potential concern but introducing another due to the promise of a referendum on the UK remaining part of the EU. The government maintained its tight fiscal policy stance but the more recent downturn in expectations for economic growth has made it more difficult to return the public sector net borrowing to a balanced annual position within the period of this parliament.

3. Overall Treasury Position as at 31 March 2016

At the beginning and the end of 2015/16 the Commissioner's treasury (excluding borrowing by PFI and finance leases) position was as follows:

Treasury Position 2015/16	*31 March 2015 Principal*	*Rate/ Return*	*Average Life yrs*	*31 March 2016 Principal*	*Rate/ Return*	*Average Life yrs*
Total debt	***£10.2m***	***4.66%***	***16.0***	***£9.8m***	***4.66%***	***15.0***
CFR	***£24.4m***			***£23.6m***		
Over / (under) borrowing	***(£14.2m)***			***(£13.9m)***		
Total investments	***£15.1m***	***0.43%***		***£17.9m***	***0.48%***	
Net debt	**(£4.9m)**			**(£8.2m)**		

The position at 31 March 2016 is still subject to audit.

4. The Strategy for 2015/16

The expectation for interest rates within the treasury management strategy for 2015/16 anticipated low but rising Bank Rate, (starting in quarter 1 of 2016), and gradual rises in medium and longer term fixed borrowing rates during 2016/17. 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 sharp volatility in equity markets during the year was reflected in sharp volatility in bond yields. However, the overall dominant trend in bond yields since July 2015 has been for yields to fall to historically low levels as forecasts for inflation have repeatedly been revised downwards and expectations of increases in central rates have been pushed back.

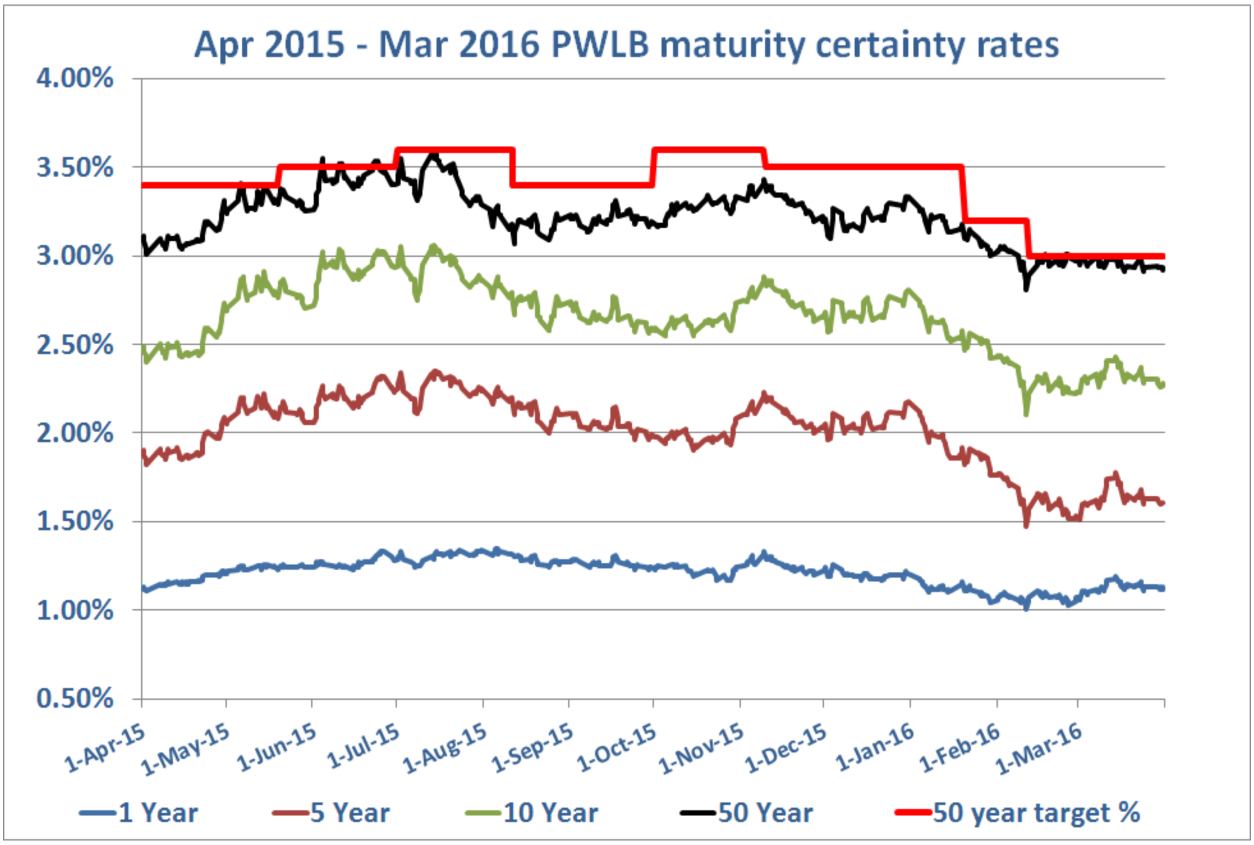
5. The Borrowing Requirement and Debt

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

	31 March 2015 Actual	*31 March 2016 Budget*	*31 March 2016 Actual*
CFR General Fund (£m)	24.4	23.6	23.6

6. Borrowing Rates in 2015/16

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

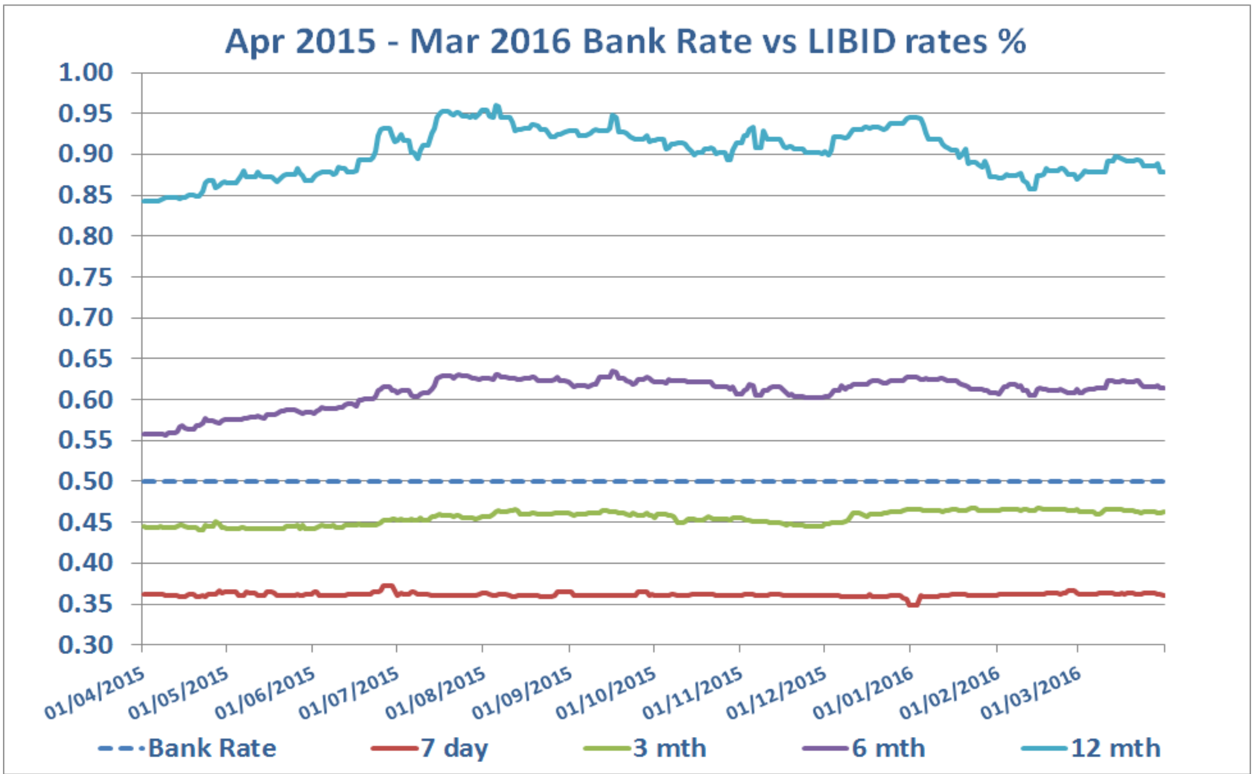


7. Borrowing Outturn for 2015/16

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

Rescheduling
No rescheduling was done during the year as the average 1% differential between PWLB new borrowing rates and premature repayment rates made rescheduling unviable.

8. Investment Rates in 2015/16



Bank Rate remained at its historic low of 0.5% throughout the year; it has now remained unchanged for seven years. Market expectations as to the timing of the start of monetary tightening started the year at quarter 1 2016 but then moved back to around quarter 2 2018 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 and due to the continuing weak expectations as to when Bank Rate would start rising.

9. Investment Outturn for 2015/16

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 9th June 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.).

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 £25,902,629 of internally managed funds. The internally managed funds earned an average rate of return of 0.4754%. The comparable performance indicator is the average 7-day LIBID rate, which was 0.36156%

Appendix 1: Prudential and Treasury Indicators

During 2015/16, 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	*2014/15 Actual £000*	*2015/16 Original £000*	*2015/16 Actual £000*
Capital expenditure	5,634	4,434	4,434
Capital Financing Requirement:	24,434	23,627	23,627
Gross borrowing	10,191	9,762	9,762
External debt	10,191	9,762	9,762
Investments (Under 1 year)	14,928	18,798	17,915
Net borrowing	(4,737)	(9,036)	(8,153)

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 (2015/16) plus the estimates of any additional capital financing requirement for the current (2016/17) 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 his immediate capital needs in 2015/16.

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 his 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.

	2015/16
Authorised limit	£14.8m
Maximum gross borrowing position	£10.2m
Operational boundary	£11.8m
Average gross borrowing position	£10.0m
Financing costs as a proportion of net revenue stream	0.92%

TABLE 1	*31 March 2015 Principal*	*Rate/ Return*	*Average Life yrs*	*31 March 2016 Principal*	*Rate/ Return*	*Average Life yrs*
Fixed rate funding:						
-PWLB	£10.2m	4.66%		£9.8m	4.66	
Total debt	***£10.2m***	***4.66%***	***16.0***	***£9.8m***	***4.66%***	***15.0***
CFR	***£24.4m***			***£23.6m***		
Over/ (under) borrowing	***(£14.2m)***			***(£13.9m)***		
Total investments	***£15.1m***	***0.43%***		***17.9m***	***0.48%***	
Net debt	**(£4.9m)**			***(£8.2m)***		

The maturity structure of the debt portfolio was as follows:

	31 March 2015 actual	*31 March 2016 actual*
Under 12 months	£0.4m	£0.4m
12 months and within 24 months	£0.4m	£0.5m
24 months and within 5 years	£1.5m	£1.5m
5 years and within 10 years	£2.9m	£3.1m
10 years and over	£4.9m	£4.2m

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 2015 Actual £000	*2015/16 Original Limits £000*	*31 March 2016 Actual £000*
Fixed rate (principal or interest) based on net debt	10,191	10,191	9,762
Upper Limit on fixed interest rates based on net debt	11,841	11,415	11,412