Annual Treasury Management Review

2016/17

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 2016/17. 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 2016/17 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)

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 Business Coordination Board before they were reported to the Commissioner.

2. The Economy and Interest Rates

The two major landmark events that had a significant influence on financial markets in the 2016-17 financial year were the UK EU referendum on 23 June and the election of President Trump in the USA on 9 November. The first event had an immediate impact in terms of market expectations of when the first increase in Bank Rate would happen, pushing it back from quarter 3 2018 to quarter 4 2019. At its 4 August meeting, the Monetary Policy Committee (MPC) cut Bank Rate from 0.5% to 0.25% and the Bank of England's Inflation Report produced forecasts warning of a major shock to economic activity in the UK, which would cause economic growth to fall almost to zero in the second half of 2016. The MPC also warned that it would be considering cutting Bank Rate again towards the end of 2016 in order to support growth. In addition, it restarted quantitative easing with purchases of £60bn of gilts and £10bn of corporate bonds, and also introduced the Term Funding Scheme whereby potentially £100bn of cheap financing was made available to banks.

In the second half of 2016, the UK economy confounded the Bank's pessimistic forecasts of August. After a disappointing quarter 1 of only +0.2% GDP growth, the three subsequent quarters of 2016 came in at +0.6%, +0.5% and +0.7% to produce an annual growth for 2016 overall, compared to 2015, of no less than 1.8%, which was very nearly the fastest rate of growth of any of the G7 countries. Needless to say, this meant that the MPC did not cut Bank Rate again after August but, since then, inflation has risen rapidly due to the effects of the sharp devaluation of sterling after the referendum.

3. Overall Treasury Position as at 31 March 2017

At the beginning and the end of 2016/17 the Commissioner's treasury (excluding borrowing by PFI and finance leases) position was as follows:

Treasury Position 2016/17	*31 March 2016 Principal*	*Rate/ Return*	*Average Life yrs*	*31 March 2017 Principal*	*Rate/ Return*	*Average Life yrs*
Total debt	***£9.8m***	***4.63%***	***16.0***	***£9.3m***	***4.66%***	***15.0***
CFR	***£23.6m***			***£22.8m***		
Over / (under) borrowing	***(£13.9m)***			***(£13.5m)***		
Total investments	***£17.9m***	***0.43%***		***£16.5m***	***0.48%***	
Net debt	**(£8.2m)**			**(£7.2m)**		

The position at 31 March 2017 is still subject to audit.

4. The Strategy for 2016/17

The expectation for interest rates within the treasury management strategy for 2016/17 anticipated low but rising Bank Rate, (starting in quarter 1 of 2017), 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.

During 2016/17 there was major volatility in PWLB rates with rates falling during quarters 1 and 2 to reach historically very low levels in July and August, before rising significantly during quarter 3, and then partially easing back towards the end of the year.

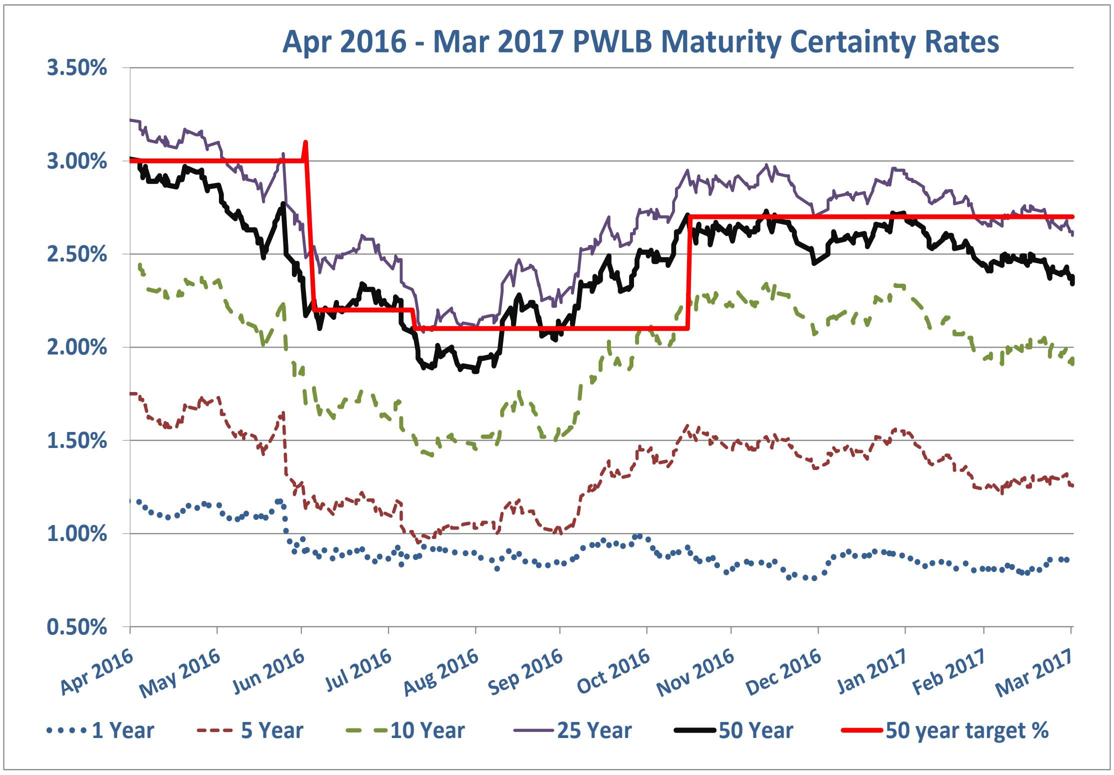
5. The Borrowing Requirement and Debt

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)	23.6	22.8	22.8

6. Borrowing Rates in 2016/17

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



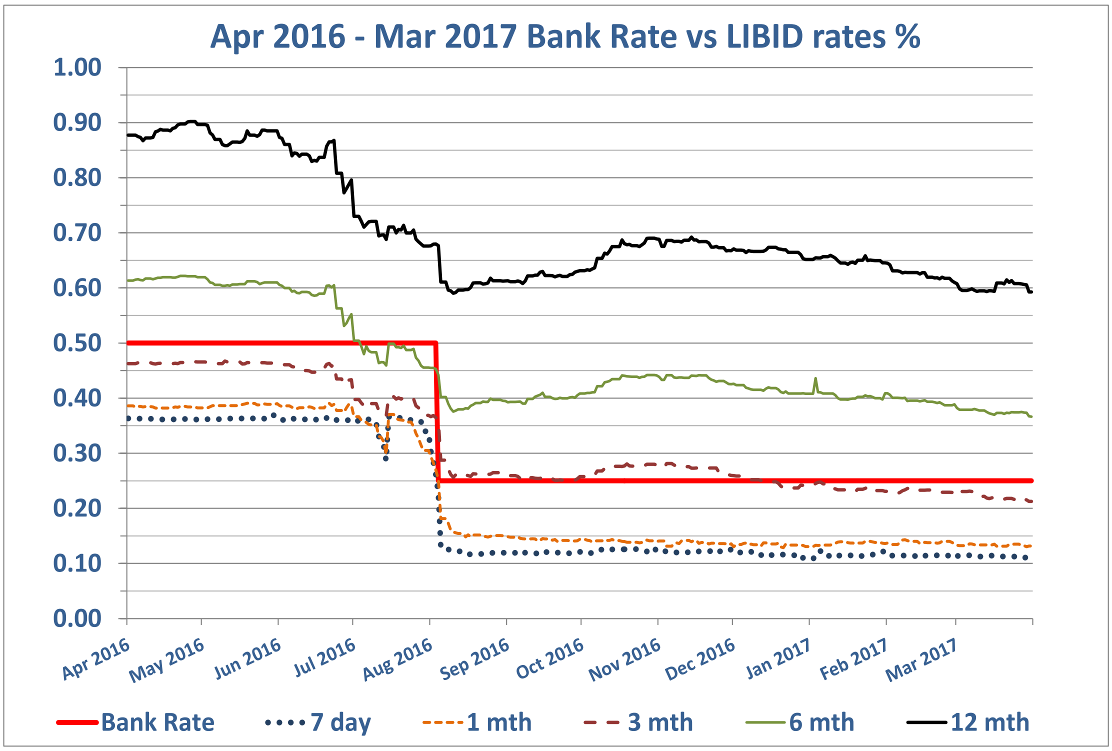
7. Borrowing Outturn for 2016/17

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 2016/17

After the EU referendum, Bank Rate was cut from 0.5% to 0.25% on 4 August and remained at that level for the rest of the year. Market expectations as to the timing of the start of monetary tightening started the year at quarter 3 2018, but then moved back to around the end of 2019 in early August before finishing the year back at quarter 3 2018. Deposit rates continued into the start of 2016/17 at previous depressed levels but then fell during the first two quarters and fell even further after the 4 August MPC meeting resulted in a large tranche of cheap financing being made available to the banking sector by the Bank of England. Rates made a weak recovery towards the end of 2016 but then fell to fresh lows in March 2017.



9. Investment Outturn for 2016/17

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. 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 £27,486,164 of internally managed funds. The internally managed funds earned an average rate of return of 0.43%. The comparable performance indicator is the average 7-day LIBID rate, which was 0.20%.

Appendix 1: Prudential and Treasury Indicators

During 2016/17, 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	*2015/16 Actual £000*	*2016/17 Original £000*	*2016/17 Actual £000*
Capital expenditure	4,434	4,824	4,284
Capital Financing Requirement:	23,627	22,816	22,816
Gross borrowing	9,762	9,313	9,313
External debt	9,762	9,313	9,313
Investments (Under 1 year)	17,915	10,991	16,500
Net borrowing	(8,153)	(1,678)	(7,187)

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 (2016/17) plus the estimates of any additional capital financing requirement for the current (2017/18) 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 2016/17.

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 2016/17 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.

	2016/17
Authorised limit	£14.4m
Maximum gross borrowing position	£9.8m
Operational boundary	£11.4m
Average gross borrowing position	£9.5m
Financing costs as a proportion of net revenue stream	0.92%

TABLE 1	*31 March 2016 Principal*	*Rate/ Return*	*Average Life yrs*	*31 March 2017 Principal*	*Rate/ Return*	*Average Life yrs*
Fixed rate funding:						
-PWLB	£9.8m	4.63%		£9.3m	4.63	
Total debt	***£9.8m***	***4.63%***	***16.0***	***£9.3m***	***4.63%***	***15.0***
CFR	***£23.6m***			***£22.8m***		
Over/ (under) borrowing	***(£13.9m)***			***(£13.5m)***		
Total investments	***£17.9m***	***0.43%***		***16.5m***	***0.48%***	
Net debt	**(£8.2m)**			***(£7.2m)***		

The maturity structure of the debt portfolio was as follows:

	31 March 2016 actual	*31 March 2017 actual*
Under 12 months	£0.4m	£0.5m
12 months and within 24 months	£0.5m	£0.5m
24 months and within 5 years	£1.5m	£1.6m
5 years and within 10 years	£3.1m	£3.2m
10 years and over	£4.2m	£3.5m

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 2016 Actual £000	*2016/17 Original Limits £000*	*31 March 2017 Actual £000*
Fixed rate (principal or interest) based on net debt	9,762	9,313	9,313
Upper Limit on fixed interest rates based on net debt	11,412	11,412	11,412