Annual Treasury Management Review
2019/20

Cambridgeshire Police & Crime Commissioner
July 2020

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1. Introduction

The Police & Crime Commissioner (the PCC) 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 2019/20. 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). The Prudential Code sets prudential and treasury indicators which are required to be reported on. The full set of indicators is provided in Appendix 1 and referred to in the report where appropriate.

During 2019/20 the minimum reporting requirements were that the PCC 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 PCC's previously approved policies.

The PCC 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 PCC.

2. The PCC's Capital Expenditure and Financing

The PCC undertakes capital expenditure on long-term assets. These activities may either be:

- Financed immediately through the application of capital or revenue resources (capital receipts, capital grants, revenue contributions etc.), which has no resultant impact on the PCC's borrowing need; or
- If insufficient financing is available, or a decision is taken not to apply resources, the capital expenditure will give rise to a borrowing need.

The actual capital expenditure forms one of the required prudential indicators. The table below shows the actual capital expenditure and how this was financed.

£000's	*2018/19 Actual*	*2019/20 Budget*	*2019/20 Actual*
Capital expenditure	4,965	14,078	9,124
Financed in year	4,965	14,078	9,124
Unfinanced capital expenditure	0	0	0

3. The PCC's Overall Borrowing Need

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

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 PCC should ensure that gross external borrowing does not, except in the short term, exceed the total of the capital financing requirement in the preceding year (2018/19) plus the estimates of any additional capital financing requirement for the current (2019/20) and next two financial years. This essentially means that the PCC is not borrowing to support revenue expenditure. This indicator allowed the PCC some flexibility to borrow in advance of its immediate capital needs in 2019/20. The table below highlights the PCC's gross borrowing position against the CFR. The PCC has complied with this prudential indicator.

	31 March 2019 Actual	*31 March 2020 Actual*
CFR General Fund (£m)	21.0	22.2
Gross Borrowing Position (£m)	18.6	17.8
(Under)/over funding of CFR (£m)	(2.4)	(4.4)

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 PCC does not have the power to borrow above this level. The table below demonstrates that during 2019/20 the PCC has maintained gross borrowing within the authorised limit.

The operational boundary – the operational boundary is the expected borrowing position of the PCC during the year. Periods where the actual position is either below or over the boundary are 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.

	2019/20
Authorised limit	£23.0m
Maximum gross borrowing position	£18.8m
Operational boundary	£20.0m
Average gross borrowing position	£18.1m
Financing costs as a proportion of net revenue stream	0.8%

4. Treasury Position as at 31 March 2020

At the beginning and the end of 2019/20 the PCC's treasury (excluding borrowing by PFI and finance leases) position was as follows:

Treasury Position 2019/20	*31 March 2019 Principal*	*Rate/ Return*	*Average Life yrs*	*31 March 2020 Principal*	*Rate/ Return*	*Average Life yrs*
Total debt	*£18.6m*	*4.25%*	*15.5*	*£17.8m*	*4.25%*	*14.5*
CFR	*£21.0m*			*£22.2m*		
Over / (under) borrowing	*(£2.4m)*			*(£4.4m)*		
Total investments	*£10.0m*	*0.85%*		*£10.9m*	*0.12%*	
Net debt	£8.6m			£6.9m		

All investments within the portfolio were short term. Liquidity of investments was sought toward year end whilst the effects of the lockdown became known. The structure of the investment portfolio comprised:

TREASURY PORTFOLIO				
	31 March 2019		**31 March 2020**	
Treasury Investments	**£000**	**%**	**£000**	**%**
Banks (UK)	5,950	60%	10,930	100%
Banks (Rest of World)	4,000	40%	0	0%
Local Authorities	0	0%	0	0%
DMADF (H.M.Treasury)	0	0%	0	0%
Money Market Funds	0	0%	0	0%
Certificates of Deposit	0	0%	0	0%
Total Managed In-house	**9,950**	**100%**	**10,930**	**100%**
Bond Funds	0	0%	0	0%
Property Funds	0	0%	0	0%
Total Managed Externally	**0**	**0%**	**0**	**0%**
Total Treasury Investments	**9,950**	**100%**	**10,930**	**100%**
Treasury External Borrowing				
Local Authorities	0	0%	0	0%
PWLB	18,567	100%	17,839	100%
Total External Borrowing	**18,567**	**100%**	**17,839**	**100%**
Net Treasury Investments / (Borrowing)	**(8,617)**		**(6,909)**	

5. The Strategy for 2019/20

5.1 Investment strategy and control of interest rate risk

Investment returns remained low during 2019/20. The expectation for interest rates within the treasury management strategy for 2019/20 was that Bank Rate would stay at 0.75% during 2019/20 as it was not expected that the MPC would be able to deliver on an increase in Bank Rate until the Brexit issue was finally settled. However, there was an expectation that Bank Rate would rise after that issue was settled, but would only rise to 1.0% during 2020.

Rising concerns over the possibility that the UK could leave the EU at the end of October 2019 caused longer term investment rates to be on a falling trend for most of April to September. They then rose after the end of October deadline was rejected by the Commons but fell back again in January before recovering again after the 31 January departure of the UK from the EU. When the coronavirus outbreak hit the UK in February/March, rates initially plunged but then rose sharply back up again due to a shortage of liquidity in financial markets. As longer term rates were significantly higher than shorter term rates during the year, value was therefore sought by placing longer term investments where cash balances were sufficient to allow this.

While the PCC has taken a cautious approach to investing, it is also fully appreciative of changes to regulatory requirements for financial institutions in terms of additional capital and liquidity that came about in the aftermath of the financial crisis. These requirements have provided a far stronger basis for financial institutions, with annual stress tests by regulators evidencing how institutions are now far more able to cope with extreme stressed market and economic conditions.

Investment balances have been kept to a minimum through the agreed strategy of using reserves and balances to support internal borrowing, rather than borrowing externally from the financial markets. External borrowing would have incurred an additional cost, due to the differential between borrowing and investment. Such an approach has also provided benefits in terms of reducing the counterparty risk exposure, by having fewer investments placed in the financial markets.

5.2 Borrowing strategy control of interest rate risk

During 2019/20, the PCC maintained an under-borrowed position. This meant that the capital borrowing need, (the Capital Financing Requirement), was not fully funded with loan debt, as cash supporting the PCC's reserves, balances and cash flow was used as an interim measure. This strategy was prudent as investment returns were low and minimising counterparty risk on placing investments also needed to be considered.

A cost of carry remained during the year on any new long-term borrowing that was not immediately used to finance capital expenditure, as it would have caused a temporary increase in cash balances; this would have incurred a revenue cost – the difference between (higher) borrowing costs and (lower) investment returns.

The policy of avoiding new borrowing by running down spare cash balances, has served well over the last few years. However, this was kept under review to avoid incurring higher borrowing costs in the future when the PCC may not be able to avoid new borrowing to finance capital expenditure and/or the refinancing of maturing debt.

Against this background and the risks within the economic forecast, caution was adopted with the treasury operations. The Director of Finance therefore monitored interest rates in financial markets and adopted a pragmatic strategy based upon the following principles to manage interest rate risks:

- if it had been felt that there was a significant risk of a sharp FALL in long and short term rates, (e.g. due to a marked increase of risks around relapse into recession or of risks of deflation), then long term borrowings would have been postponed, and potential rescheduling from fixed rate funding into short term borrowing would have been considered.

- if it had been felt that there was a significant risk of a much sharper RISE in long and short term rates than initially expected, perhaps arising from an acceleration in the start date and in the rate of increase in central rates in the USA and UK, an increase in world economic activity or a sudden increase in inflation risks, then the portfolio position would have been re-appraised. Most likely, fixed rate funding would have been drawn whilst interest rates were lower than they were projected to be in the next few years.

Interest rate forecasts expected only gradual rises in medium and longer term fixed borrowing rates during 2019/20 and the two subsequent financial years. Variable, or short-term rates, were expected to be the cheaper form of borrowing over the period.

Link Asset Services Interest Rate View 31.3.20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22
Bank Rate View	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
3 Month LIBID	0.45	0.40	0.35	0.30	0.30	0.30	0.30	0.30
6 Month LIBID	0.60	0.55	0.50	0.45	0.40	0.40	0.40	0.40
12 Month LIBID	0.75	0.70	0.65	0.60	0.55	0.55	0.55	0.55
5yr PWLB Rate	1.90	1.90	1.90	2.00	2.00	2.00	2.10	2.10
10yr PWLB Rate	2.10	2.10	2.10	2.20	2.20	2.20	2.30	2.30
25yr PWLB Rate	2.50	2.50	2.50	2.60	2.60	2.60	2.70	2.70
50yr PWLB Rate	2.30	2.30	2.30	2.40	2.40	2.40	2.50	2.50

5.3 PWLB Changes

PWLB rates are based on, and are determined by, gilt (UK Government bonds) yields through H.M.Treasury determining a specified margin to add to gilt yields. Gilt yields were on a generally falling trend during the last year up until the coronavirus crisis hit western economies. Since then, gilt yields have fallen sharply to unprecedented lows as investors have panicked in selling shares in anticipation of impending recessions in western economies, and moved cash into safe haven assets i.e. government bonds. However, major western central banks also started quantitative easing purchases of government bonds which will act to maintain downward pressure on government bond yields at a time when there is going to be a huge and quick expansion of government expenditure financed by issuing government bonds; (this would normally cause bond yields to rise). At the close of the day on 31 March, all gilt yields from 1 to 5 years were between 0.12 – 0.20% while even 25-year yields were at only 0.83%.

However, HM Treasury has imposed two changes in the margins over gilt yields for PWLB rates in 2019/20 without any prior warning; the first on 9 October 2019, added an additional 1% margin over gilts to all PWLB rates in response to the increasing use of PWLB loans across other parts of the public sector being used to fund commercial investments for return. That increase was then partially reversed for some forms of borrowing on 11 March 2020, at the same time as the Government announced in the Budget a programme of increased spending on infrastructure expenditure. It also announced that there would be a consultation with local authorities on possibly further amending these margins; this ended on 4 June. It is clear that the Treasury intends to put a stop to local authorities borrowing money from the PWLB to purchase commercial property if the aim is solely to generate an income stream.

Following the changes on 11 March 2020 in margins over gilt yields, the current situation is as follows (notes 100 basis points equals 1%): -

- **PWLB Standard Rate** is gilt plus 200 basis points (G+200bps)
- **PWLB Certainty Rate** is gilt plus 180 basis points (G+180bps)
- **PWLB Housing Revenue Account Standard Rate** is gilt plus 100 basis points (G+100bps)
- **PWLB Housing Revenue Account Certainty Rate** is gilt plus 80bps (G+80bps)
- **Local Infrastructure Rate** is gilt plus 60bps (G+60bps)

There is likely to be little upward movement in PWLB rates over the next two years as it will take national economies a prolonged period to recover all the momentum they will lose in the sharp recession that will be caused during the coronavirus shut down period. Inflation is also likely to be very low during this period and could even turn negative in some major western economies during 2020/21.

6. Borrowing Outturn

Borrowing

Due to investment concerns, both counterparty risk and low investment returns, no further borrowing was undertaken during the year. Current loans held by the PCC are all with the Public Works Loan Board (PWLB) and total £17.8m as at 31 March 2020.

Borrowing in advance of need

The PCC has not borrowed more than, or in advance of its needs, purely in order to profit from the investment of the extra sums borrowed.

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.

7. Investment Outturn

Investment Policy

The PCC’s investment policy is governed by the Ministry of Housing, Communities and Local Government (MHCLG) guidance, which has been implemented in the annual investment strategy approved by the PCC. 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 PCC had no liquidity difficulties.

Investments held by the PCC

The PCC maintained an average balance of £24.6m of internally managed funds. The internally managed funds earned an average rate of return of 0.71%. The comparable performance indicator is the average 7-day LIBID rate, which was 0.53%. Total investment income was £175k compared to a budget of £114k.

8. Conclusion

The active approach to investments has served well this year; using diversity of products to provide better opportunity for yield and security of funds, whilst liquidity remained sufficient throughout the year. As the implications of the virus outbreak became more apparent the strategy in the latter part of the year shifted to liquidity. Despite the subdued outlook throughout the year and the further dampening of investment opportunities during the onset of lockdown in the UK a reasonable rate of return on funds was produced, exceeding the £114k budget by £61k.

With no further borrowing in year the debt reduced in line with expectation. PWLB's sudden introduction of a further 100 basis point margin has meant sourcing finance from the market more attractive. PWLB consultation is ongoing and more clarity about their competitiveness will be forthcoming in the new year.

9. Appendix 1: Prudential & Treasury Indicators

The following indicators are reporting requirements for Prudential and Treasury Indicators, as per the 2017 CIPFA Prudential Code for Capital Finance in Local Authorities and 2018 CIPFA Treasury Management in the Public Services Guidance Notes.

These indicators are designed for the reader to understand and evaluate the prudence and affordability of the PCC's capital expenditure plans and the borrowing and investment activities undertaken in support of this.

PRUDENTIAL INDICATORS

Capital Expenditure

This provides a summary of the PCC's capital expenditure. It reflects matters previously agreed and those proposed for the forthcoming financial periods.

Capital Expenditure		2018/19 Actual	2019/20 Actual	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate
Total Capital Expenditure	(A)	**4,965**	**9,243**	**10,691**	**21,106**	**17,037**	**4,952**
Financed by:							
Capital receipts		(1,215)	(1,863)	(922)	(3,500)	-	-
Revene contribution		(508)	(493)	(1,440)	(1,440)	(1,440)	(1,440)
Grants and other contributions		(3,418)	(6,887)	(8,329)	(1,640)	(136)	(136)
Finance lease and PFI liabilities		-	-	-	-	-	-
Total Financing	(B)	**(5,141)**	**(9,243)**	**(10,691)**	**(6,580)**	**(1,576)**	**(1,576)**
Net financing need for year	(A)-(B)	**(176)**	**0**	**-**	**14,526**	**15,461**	**3,376**

Capital Financing Requirement (CFR)

The CFR shows the difference between the PCC's capital expenditure and the revenue or capital resources set aside to finance that spend. The CFR will increase where capital expenditure takes place and will reduce as the PCC makes Minimum Revenue Provision ("MRP") or Voluntary Revenue Provision ("VRP") or otherwise sets aside revenue or capital resources to finance expenditure.

Capital Financing Requirement	2018/19 Actual	2019/20 Actual	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate
Opening CFR	21,947	21,027	22,326	21,640	35,200	49,722
Capital spend	4,965	9,243	10,691	21,106	17,037	4,952
Resources used	(5,141)	(7,231)	(10,691)	(6,580)	(1,576)	(1,576)
MRP & VRP	(744)	(713)	(686)	(966)	(939)	(1,113)
Closing CFR	**21,027**	**22,326**	**21,640**	**35,200**	**49,722**	**51,985**

Authorised Limit

This represents a control on the maximum level of external debt the PCC can incur. The PCC has to show this aggregate amount split into the element in respect of actual external borrowing and that which relates to 'other long-term liabilities' - the latter being credit arrangements, as defined in statute and which will include the principle element of any finance lease or Private Finance Initiative obligations payable.

The Authorised Limit is a statutory limit determined under Section 3(1) of the Local Government Act 2003 for English and Welsh authorities, and for Scottish authorities under Regulation 6(1) of the Local Authority (Capital Finance and Accounting) (Scotland) Regulations 2016. The PCC has no legal power to borrow in excess of the limits set. Revision of this Indicator would need to be approved by the PCC in advance of any external debt taken on in excess of the limit then in force.

The Authorised Limit reflects a level of external debt that, whilst not desired, could be afforded by the PCC in the short-term, but which is not sustainable in the longer-term.

Authorised Limit	2018/19 Actual	2019/20 Actual	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate
Borrowing	23,294	22,803	43,880	62,109	66,581	65,561
Other Long Term Liabilities	200	200	200	200	200	200
Total Authorised Limit	**23,494**	**23,003**	**44,080**	**62,309**	**66,781**	**65,761**

The Operational Boundary

The Operational Boundary is the limit beyond which external debt is not normally expected to exceed. Again, the PCC is required to disclose an aggregate limit and separately disclose the element that relates to actual external borrowing and that which relates to other long-term liabilities. Unlike the Authorised Limit, the Operational Boundary is not an absolute limit but it reflects the PCC's expectations of the level at which external debt would not ordinarily be expected to exceed.

Operational Boundary	2018/19 Actual	2019/20 Actual	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate
Borrowing	20,394	19,903	38,230	54,081	57,970	57,083
Other Long Term Liabilities	100	100	100	100	100	100
Total Operational Boundary	**20,494**	**20,003**	**38,330**	**54,181**	**58,070**	**57,183**

External Debt

The PCC has to disclose the closing balance for actual gross borrowing in respect of the financial period just ended, together with the level of other long-term liabilities and so the actual aggregate level of external debt at the Balance Sheet date. This clarifies the overall level of external debt, and allow comparison to the PCC's actual borrowing need as provided by the Gross debt and the CFR Indicator.

Actual External Debt as at 31st March	2019/20 Actual
Borrowing	17,839
Other Long Term Liabilities	31
Total External Debt	**17,870**

Gross Debt and the Capital Financing Requirement

The PCC should only borrow to support a capital purpose, and borrowing should not be undertaken for revenue or speculative purposes. The PCC should ensure that gross debt does not, except in the short-term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for the three subsequent financial years. If the level of gross borrowing is below the PCC's capital borrowing need – the CFR – it demonstrates compliance with the requirement of this Indicator.

Gross Debt and the CFR	2018/19 Actual	2019/20 Actual	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate
CFR	21,027	22,326	21,640	35,200	49,722	51,985
Gross Borrowing	18,391	17,870	17,325	30,804	45,569	48,237
Under/(Over) Borrowing	**2,636**	**4,456**	**4,315**	**4,397**	**4,153**	**3,747**

Ratio of Financing Costs

This Indicator shows the trend in the cost of capital (borrowing and other long-term obligation costs net of investment income) against the net revenue stream – i.e. taxation and non-specific grant income. The higher the ratio, the higher the proportion of resources tied up just to service net capital costs, and which represent a potential affordability risk.

Ratio of Financing Costs		**2018/19 Actual**	**2019/20 Actual**	**2020/21 Estimate**	**2021/22 Estimate**	**2022/23 Estimate**	**2023/24 Estimate**
Interest cost on existing borrowing		650	627	604	579	553	526
Interest cost on new borrowing		-	-	-	-	-	-
Gains/losses on debt rescheduling		-	-	-	-	-	-
Interest and investment income		(200)	(175)	(114)	(114)	(114)	(114)
MRP & VRP		744	713	686	966	939	1,113
Total Financing Costs	(A)	**1,194**	**1,165**	**1,176**	**1,431**	**1,378**	**1,525**
Net Budget Requirement	(B)	**134,761**	**146,412**	**152,467**	**154,924**	**157,023**	**159,186**
Ratio of financing costs	(A)/(B)	**0.89%**	**0.80%**	**0.77%**	**0.92%**	**0.88%**	**0.96%**

TREASURY INDICATORS

Maturity Structure of Borrowing

The PCC is required to set gross limits on maturities for the periods shown and covers both fixed and variable rate borrowings. The reason being to try and control the PCC's exposure to large sums falling due for refinancing.

Maturity structure of borrowing:	Actual	Lower Limit	Upper Limit
Under 12 months	3%	0%	100%
12 months and within 24 months	3%	0%	100%
24 months and within 5 years	10%	0%	100%
5 years and within 10 years	20%	0%	100%
10 years and above	63%	0%	100%

Limit for Principal Sums Invested for Longer Than a Year

This Indicator is seeking to support control of liquidity risk. The limits should be set with regard to the PCC's liquidity needs and reduce the potential need to have to make early exit from an investment in order to recover funds.

	Actual	Limit
Upper limit on total principal sums invested longer than a year	£ -	£ -