Decision No 2012/09

REPORT TO: POLICE AND CRIME COMMISSIONER FOR LANCASHIRE

REPORT BY: LISA KITTO, CHIEF FINANCE OFFICER

DATE: JANUARY 2013

TITLE: TREASURY MANAGEMENT 2012/13 QUARTERLY MONITORING

Appendix A refers

EXECUTIVE SUMMARY

In accordance with the updated CIPFA Treasury Management code of practice (2011) and to strengthen members' oversight of the PCC's treasury management activities, the PCC will receive updates on treasury management issues including a mid-year report. This is a continuation of the practice that was operated under the previous governance arrangements. This report provides information on treasury management activity that has been undertaken in the current financial year and reports on the overall performance against the agreed strategy and prudential indicators.

RECOMMENDATION

The Police and Crime Commissioner is asked to note the report.

Decision taken by the Police and Crime Commissioner for Lancashire:

Original decision, as set out in the attached report, approved without amendment (please delete as appropriate)	**YES**	**NO**

Original decision required to be amended and decision as detailed below:
The reasons for the amended decision are as detailed below:

Police and Crime Commissioner: Comments

DECLARATIONS OF INTEREST

The PCC is asked to consider any personal / prejudicial interests he may have to disclose in relation to the matter under consideration in accordance with the law, the Nolan Principles and the Code of Conduct.

STATEMENT OF COMPLIANCE

The recommendations are made further to legal advice from the Monitoring Officer and the Section 151 Officer has confirmed that they do not incur unlawful expenditure. They are also compliant with equality legislation.

Signed: **Police and Crime Commissioner** **Date:**	**Signed:** **Chief Officer:** **Date:**

Signed: **Chief Constable** **Date:**	**Signed:** **Chief Finance Officer:** **Date:**

Appendix A

TREASURY MANAGEMENT 2012/13 - QUARTERLY MONITORING

The Lancashire Police Authority agreed a treasury management strategy for the 2012/13 financial year. This report sets out some of the main issues and activities that have occurred to date in relation to the strategy to assist the PCC in monitoring the latest position.

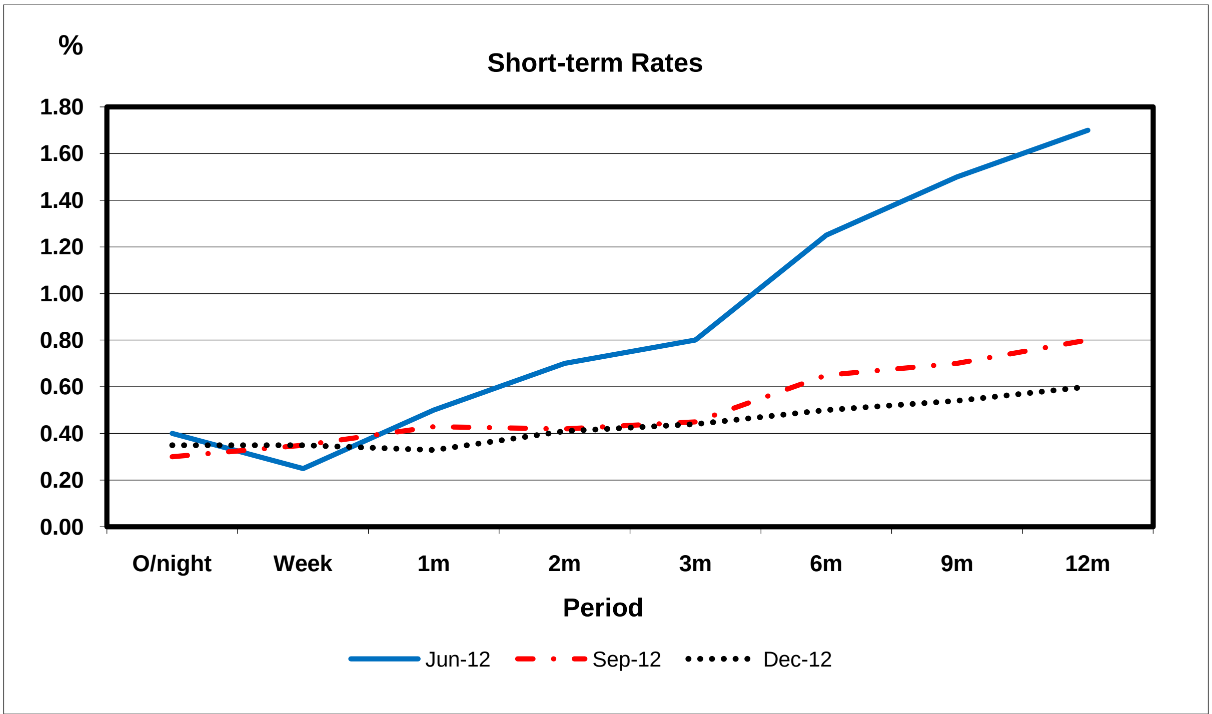
Economic Overview

Minutes from the November meeting of the Monetary Policy Committee showed a unanimous decision to leave interest rates unchanged and an 8-1 decision to leave the asset purchase scheme unchanged. The minutes state that the committee is not considering a cut in Bank Rate in its policy options for the "foreseeable future."

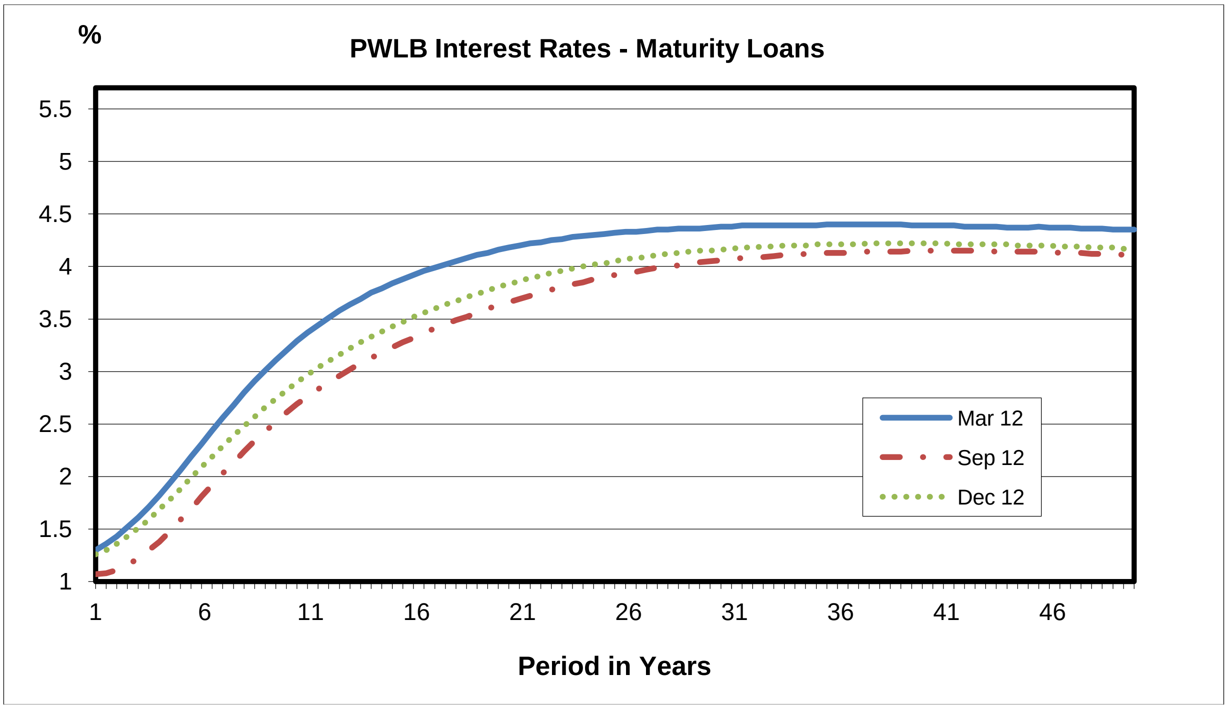
Although there is a possibility of a modest decline in Q4 GDP, the growth outlook is for a slow but sustained recovery. Headline CPI inflation is likely to remain above the 2% target for the next year, falling back to target as external commodity price pressures wane.

Interest Rates

Short term interest rates continue at the very low levels since the Bank of England reduced base rate to 0.5% in March 2009. The chart below shows the downward pressure and movement of rates over the precedent quarters.



Current longer term PWLB rates are shown below.



During the summer uncertainty in world markets has increased the demand for UK government debt which has benefited UK interest rates. The effects of this can be seen in the fall of the PWLB rates although they have bounced back during the autumn as Eurozone debt fears receded (for now.). The shape of the curve has remained constant with rates much lower at the short end.

Outlook for Interest Rates

The recent downward trend in the CPI inflation rate allied with the apparent synchronised global downturn led by the Eurozone has pushed market expectations for a rise in interest rate out to at least 2014. The risks to the forecast remain heavily to the downside, arising largely from the impact of the Eurozone sovereign debt crisis on UK business and household confidence.

Interest Rate Forecast November 2012

	Central forecast				Market forecast		
	Bank Rate	*3 month LIBID*	*12 month LIBID*	*20-year Gilt Yield*	*O/N rate (proxy for Bank Rate)*	*3 month LIBID*	*20-year Gilt Yield*
Current	**0.50**	**0.40**	**1.09**	**2.71**	**0.50**	**0.40**	**2.71**
Q4 2012	0.50	0.55	1.10	2.80	0.40	0.39	2.75
Q1 2013	0.50	0.55	1.10	2.80	0.36	0.38	2.88
Q2 2013	0.50	0.60	1.25	2.80	0.33	0.38	2.92
Q3 2013	0.50	0.60	1.25	2.80	0.31	0.38	2.98
Q4 2013	0.50	0.60	1.25	2.80	0.31	0.41	3.03
H1 2014	0.50	0.70	1.40	2.90	0.37	0.47	3.14
H2 2014	0.50	0.75	1.40	2.90	0.52	0.61	3.25
H1 2015	0.50	0.75	1.40	3.00	0.60	0.75	3.36
H2 2015	0.50	0.75	1.40	3.00	0.84	0.94	3.47

Borrowing

Since 2008-09 the Police & Crime Commissioner for Lancashire's (formerly known as Lancashire Police Authority) cash investments have been in excess of the borrowing requirement and so to avoid excess borrowing and in order to reduce credit rate risk, balances have been used to fund capital programme expenditure and no borrowing has been taken over this period..

After finalisation of the capital out-turn for 2011/12, the carry-forward of the borrowing requirement position from 2010/11, the inclusion of maturing loans and the Minimum Revenue Provision (MRP) adjustment, the actual borrowing requirement as at 31.3.12 shown in the table below was reported to the Police Authority's Treasurer in June 2012.

	2011-12	**2011-12**	**2012-13**	**2013-14**
	Estimate	**Actual**	**Estimate**	**Estimate**
	£'000	**£'000**	**£'000**	**£'000**
Total Debt Outstanding	24,654	24,654	23,654	33,835

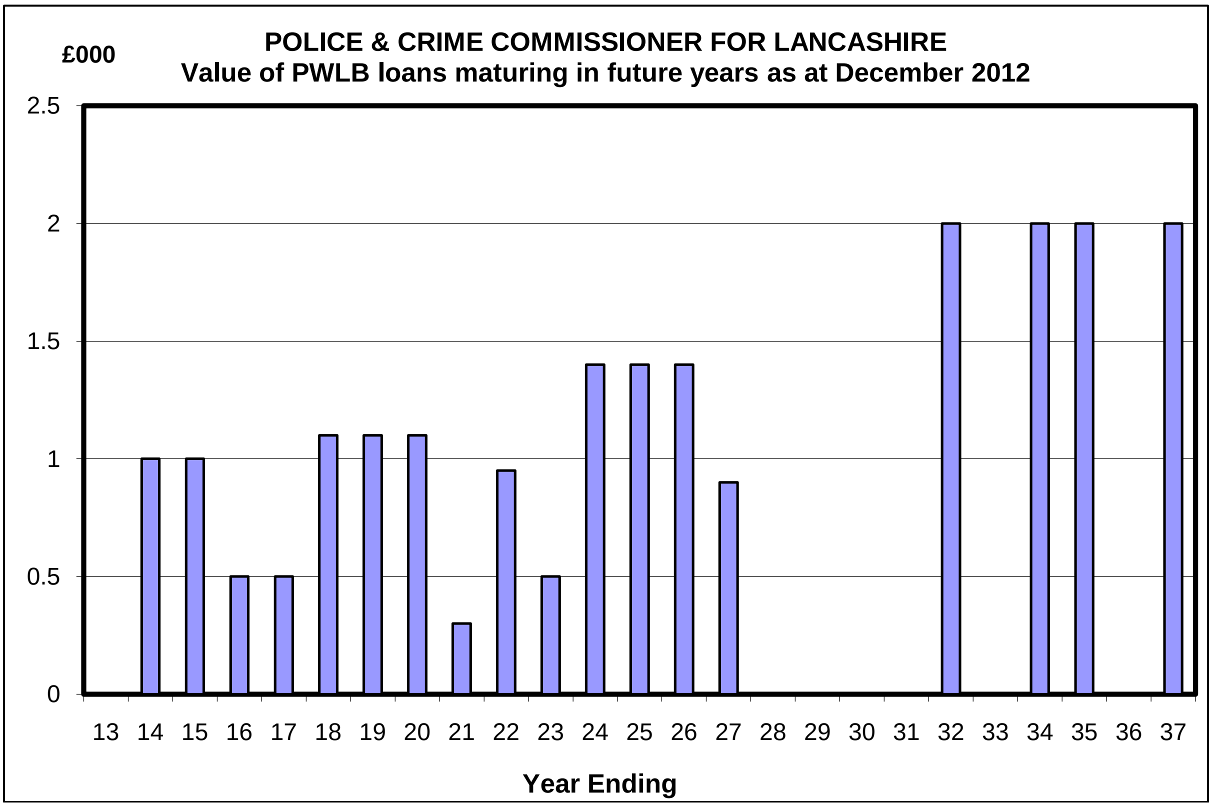
Borrowing requirement b/fwd from previous year	11,360	11,360	12,547	-
Current Year Borrowing Requirement	1,999	1,567	1,510	3,892
Maturing Debt	1,000	1,000	2,500	1,000
Less MRP	-1,380	-1,380	-1,376	-1,393
Total Borrowing Requirement	**12,979**	**12,547**	**15,181**	**3,499**
In year debt repayment	1,000	1,000	2,500	1,000
New Borrowing	-	-	12,681	2,499
Total Debt Outstanding	**23,654**	**23,654**	**33,835**	**35,334**

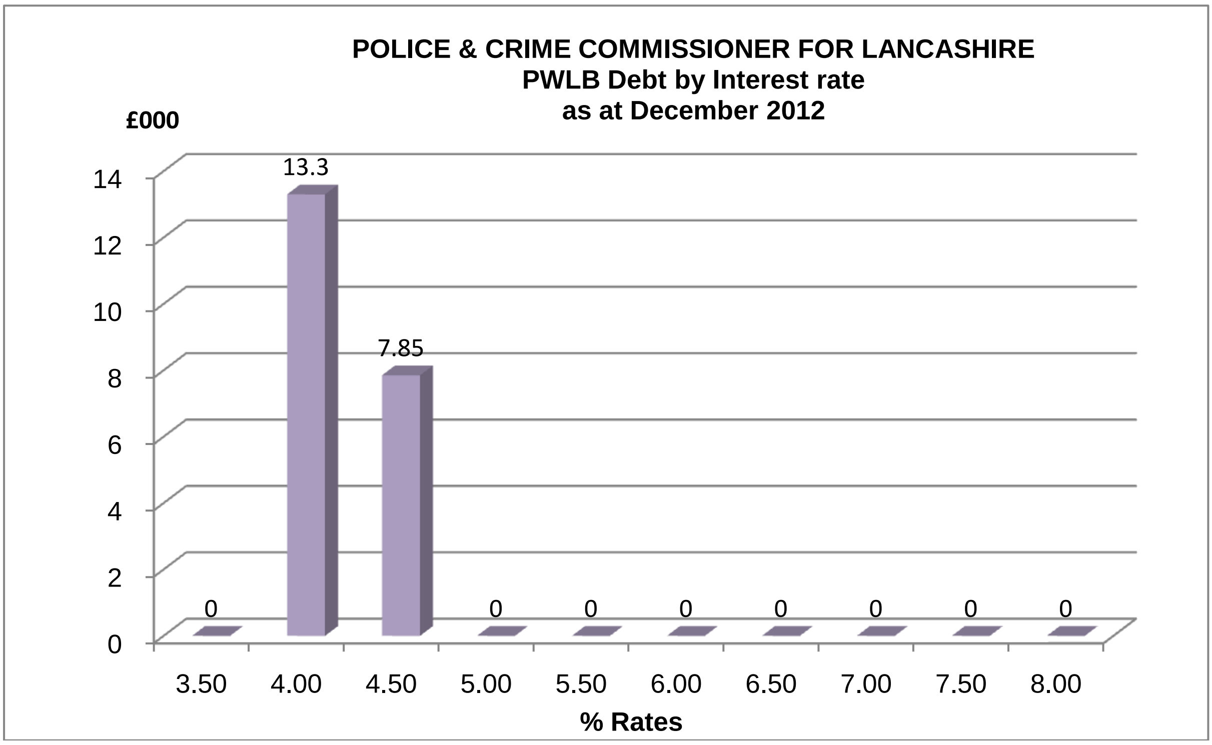
The net borrowing requirement brought forward is £12,547,000. The 2012/13 borrowing requirement including the carry forward from previous years is £15,181,000. The total amount of long term borrowing as at 31th March 2012 is £23,654,000. If no borrowing is taken during the current financial year the total outstanding debt at 31.03.2013 will be £21,154,000 following two PWLB loan maturities (at 4.35% and 3.59%) during March 2013.

Currently the cost of borrowing is higher than the rate which can be earned on investments. Given the general economic situation, the interest rate forecast predicting no rate rise until mid 2013, and the current level of balances, there is no imperative to borrow in the current financial year. The situation is constantly monitored but the assumption in the table above is that the borrowing requirement will be carried forward to 2013-14.

The government have recently announced details of the new PWLB 'certainty rate'.
The rate is 20 basis points below the standard rate (which is currently gilts plus 100 basis points) across all loan types and maturities. The PCC was successful in its application to access the certainty rate.

The chart below shows the current maturity profile of the PCC's borrowings.





Investments

In line with the 2012-13 treasury management strategy, Lancashire County Council is the counterparty for all of PCC's investments.

The continued stress within the global financial sector has led the major credit ratings agencies to proactively reassess the credit strength of individual institutions as well as the governments in the countries where the institutions are domiciled.

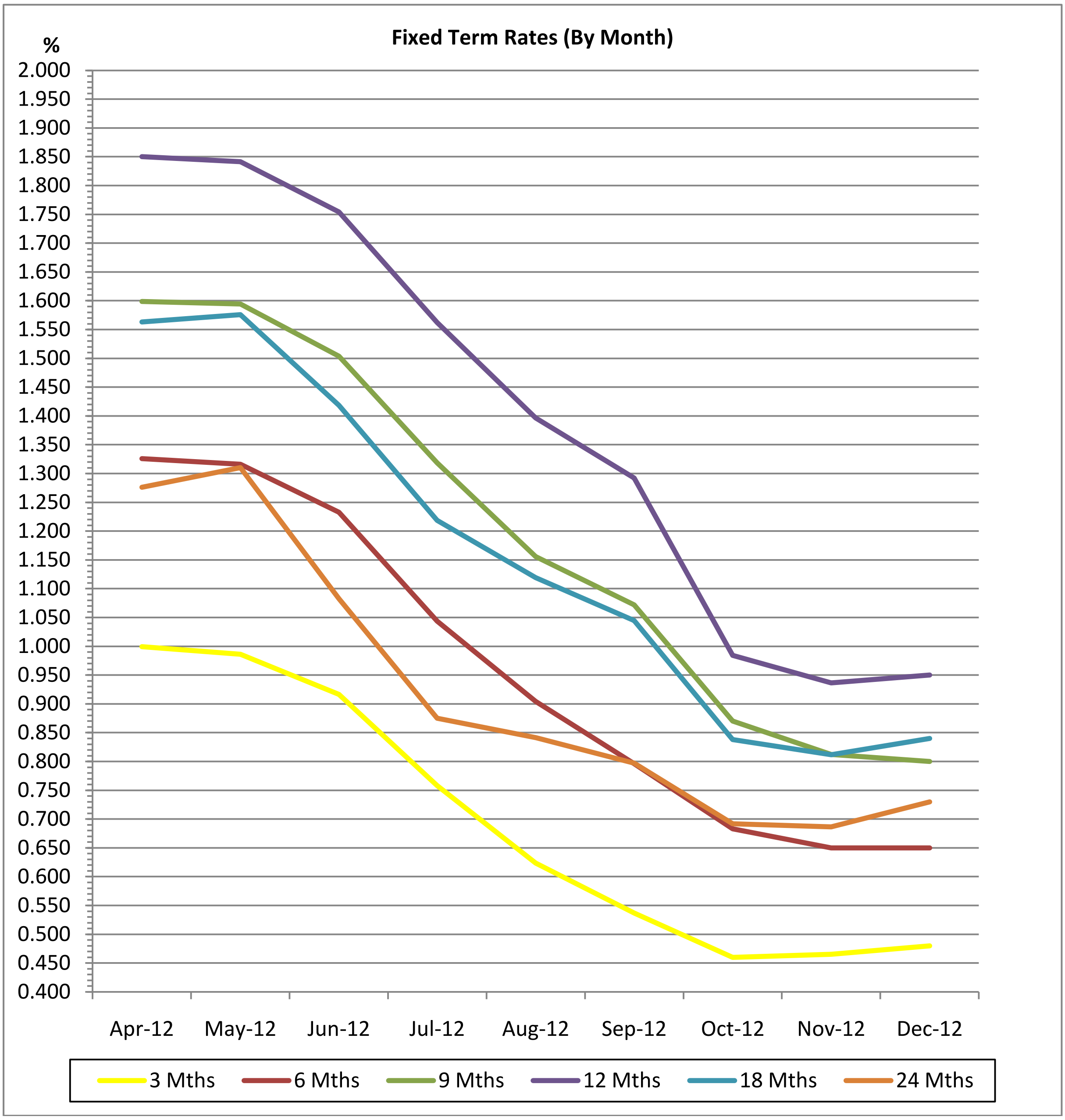
The County Council's counterparty credit criteria, set for the 2012/13 treasury management strategy, always represented a low risk policy resulting in a limited number of available counter party institutions, but nevertheless at the point of construction this still gave sufficient bank diversity when taken in conjunction with the ability to invest in Government and Supra national bonds.

However, during the year the rate at which banks have dropped out of the County Council's credit matrix due to downgrading in their credit ratings has been relentless, and as a result of November downgrades of the French state and Dutch and Scandinavian banking systems, there were no longer any non government owned or guaranteed banks worldwide that would meet the counterparty credit criteria. Consequently the County Council has recently recast the credit criteria to allow more flexibility by using not just credit ratings but also information from the credit default swap market to provide more flexibility within the policy whilst ensuring the Council transacts with only the highest quality counter-parties.

The County Council has AA+ credit rating from Moody's ratings agency, and having the ability to place all investments with an organisation of such high credit quality significantly reduces the counterparty credit risk to which PCC is exposed.

The Police & Crime Commissioner for Lancashire is able to make investments with LCC at any time. The cash flow position along with the investment situation and interest rate environment form part of the regular discussions between the PCC's Chief Finance Officer and Lancashire County Council's Treasury Management Team. All investments are made in accordance with the current Treasury Management Strategy and the CIPFA treasury management code of practice.

The chart below shows the current interest rates for different maturities and how rates have been on a downward trend since April 2012.



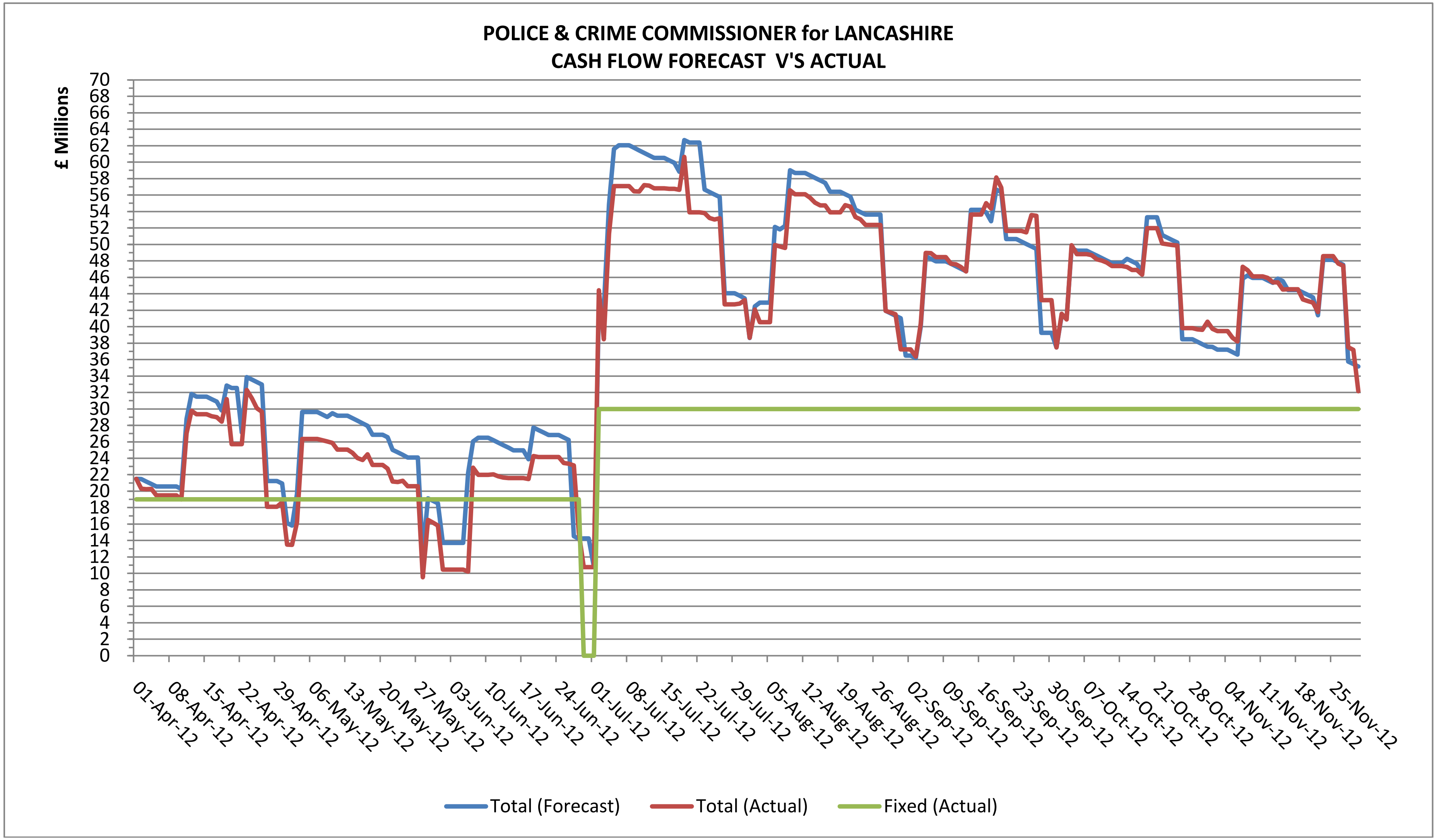
The PCC has access to a call (instant access) account, which currently pays 20 basis points (0.20%) above bank rate, at the present time this is 0.70%. Each working day the balance on the PCC's Current Account is invested in this to ensure that the interest received on surplus balances is maximised.

In addition PCC is able to make specific investments with LCC at any time, and has currently made the following investments.

INV Number	Start Date	Maturity Date	Amount £M	Duration	Interest Rate	Interest on Maturity £
LPA3	01-07-2011	29-06-2012	15,000	364 days	1.54%	230,367.12
LPA4	30-12-2011	29-06-2012	4,000	182 days	1.36%	27,125.48
PCC5	02-07-2012	01-07-2013	15,000	364 days	1.65%	246,821.92
PCC6	02-07-2012	31-12-2012	15,000	182 days	1.14%	85,265.75

The overall combined amount of interest earned on Fixed/Call balances as at 31st November 2012 is £302.7k on an average balance of £38.1m at an average rate of 1.19%. The current interest rate is 1.35% following the arrangement of the above fixed term deposits. This compares favourably with the benchmark 7 day notice index which averages 0.35% over the same period.

The following graph shows the recent accuracy of the cash flow projections:



Prudential Indicators

The indicators for 2012/13 are shown in the table below alongside the current actual.

	2012-13 PIs	**Actual to Date**
Adoption of the CIPFA Code of Practice for Treasury Management	Adopted	Adopted
Authorised limit for external debt	£000	£000
A prudent estimate of total external debt, which does not reflect the worst case scenario, but allows sufficient headroom for unusual cash movements		
Borrowing	44,000	21,154
Other long-term liabilities	1,000	-
Total	45,000	21,154
Operational boundary for external debt		
A prudent estimate of debt, but no provision for unusual cash movements. It represents the estimated maximum external debt arising as a consequence of the Authority's current plans		
Borrowing	41,000	21,154
Other long-term liabilities	1,000	-
Total	42,000	21,154
Upper limit for fixed interest rate exposure		
Borrowing	100%	100%
Investments	100%	93.28%
Upper limit for variable rate exposure		
Borrowing	75%	Nil
Investments	100%	6.72%
Upper limit for total principal sums invested for over 364 days (per maturity date)	75%	Nil
Maturity structure of debt	**Upper/ Lower Limits**	**Actual**
Under 12 months	50% / nil	0%
12 months and within 24 months	50% / nil	4.73%
24 months and within 5 years	50% / nil	9.45%
5 years and within 10 years	80% / nil	21.51%
10 years and above	90% / 25%	64.31%
Historically the above maturity structure has proved to be sound. It aims to produce a stable debt structure over the longer-term whilst permitting the exploitation of favourable interest rates at the short end of the market if they arise.		

Icelandic Banks

At the time the Icelandic banks collapsed in October 2008, the County Council had an investment of £10m with Landsbanki. Under the treasury management strategy in operation at that time, the PCC's share of the deposit with Landsbanki was £0.668m.

The PCC was one of many UK and Dutch Local Authorities with such deposits, all of whom were granted priority creditor status by the Icelandic Supreme Court at a hearing in Reykjavik on 14th and 15th of September 2011. The Winding Up Board announced on 9 March 2012 that it anticipated recoveries in the Landsbanki administration would exceed the book value of recognised priority claims by around ISK 121bn, taking into account the sale of its holding in Iceland Foods. Estimated recoveries are some 9% higher than the value of priority claims, and it is therefore now considered likely that UK local authorities will recover 100% of their deposits, subject to potential future exchange rate fluctuations.

The winding up board made its first distribution on 7th December 2011, the second distribution on 25th May 2012 and the 3rd distribution on 9th October 2012. Approximately 42% of the total claim has now been repaid. The table below shows the combined amount of the distributions and the amount outstanding.

CLAIM	**£**
Principal	667,648.79
Interest	9,687.68
Total	**677,336.47**
Received	£321,435.30
Claim outstanding	£355,901.17

DISTRIBUTION RECEIVED TO DATE:-

Distribution	Date	Principal	Interest	Total
1st	07/12/2011	£ 196,179.64	£ 2,846.59	£ 199,026.24
2nd	25/05/2012	£ 81,681.80	£ 1,185.21	£ 82,867.01
3rd	09/10/2012	£ 38,976.50	£ 565.55	£ 39,542.05
		£ 316,837.94	**£ 4,597.36**	**£ 321,435.30**

NB: The exact timing and amounts of future distributions is not known at this stage.

Background Papers

I. CIPFA Treasury Management Code of Practice (2011)
II. Lancashire Police Authority Treasury Management Strategy 2012/13