JOINT MANAGEMENT BOARD

ITEM : 2 Decision : 2016/27	DATE 15 NOVEMBER 2016
TITLE: Treasury Management mid-year report 2016/17	
REPORT BY: Steve Freeman, Chief Finance Officer	

Executive Summary

In accordance with the CIPFA Treasury Management code of practice and to strengthen oversight of the PCC's treasury management activities, the PCC will receive updates on treasury management issues including a mid-year report. 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.

Recommendations

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

Signature Clive Grunshaw

Police and Crime Commissioner

Date 15th November 2016

PART I

POLICE & CRIME COMMISSIONER FOR LANCASHIRE

REVIEW OF TREASURY MANAGEMENT 2016/17 Mid-Year Report

Economic Overview

The economic position in the year to date and future outlook has been significantly influenced by the vote to leave the EU in the referendum on 23rd June 2016. This led to many economic commentators reducing their forecasts of economic growth. The risk of reduced growth was judged by the Bank of England to be severe, prompting the Monetary Policy Committee to initiate substantial monetary policy easing at its August meeting to mitigate the worst of the downside risks. This included a cut in Bank Rate to 0.25%, further gilt and corporate bond purchases (QE) and cheap funding for banks to maintain the supply of credit to the economy. Although the impact of the vote to leave the EU is highly speculative it is likely that the uncertainty on future trade relations will impact on growth and future reduction in rates are possible.

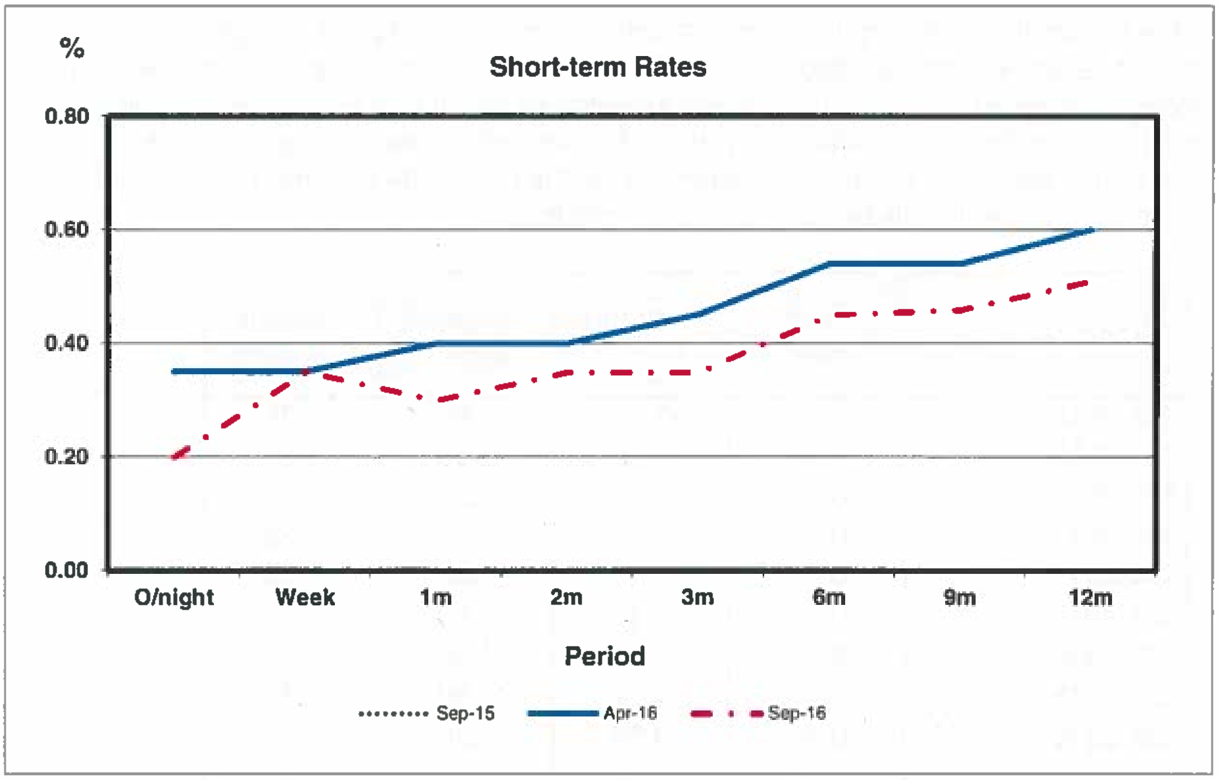
During the first part of the financial year the economy has grown. The first estimate of Q3 GDP released by the ONS showed the UK economy growing by 0.5% over the quarter and 2.3% year-on-year. Both of these figures were slightly above market expectations. The Q2 growth rates were growth of 0.7% over the quarter and 2.1% year on year.

The period has seen some change in inflation. Following BREXIT there has been a fall in the value of sterling which along with the near doubling in the price of oil in 2016 have combined to drive inflation expectations higher. Twelve-month CPI inflation had increased by 0.4% to 1.0% in September. The Bank of England is forecasting that Consumer Price Inflation will breach its 2% target in 2017, the first time since late 2013. However, the rise in inflation is highly unlikely to prompt monetary tightening by the Bank of England, with policymakers looking through import-led CPI spikes, concentrating instead on the negative effects of Brexit on economic activity and, ultimately, inflation

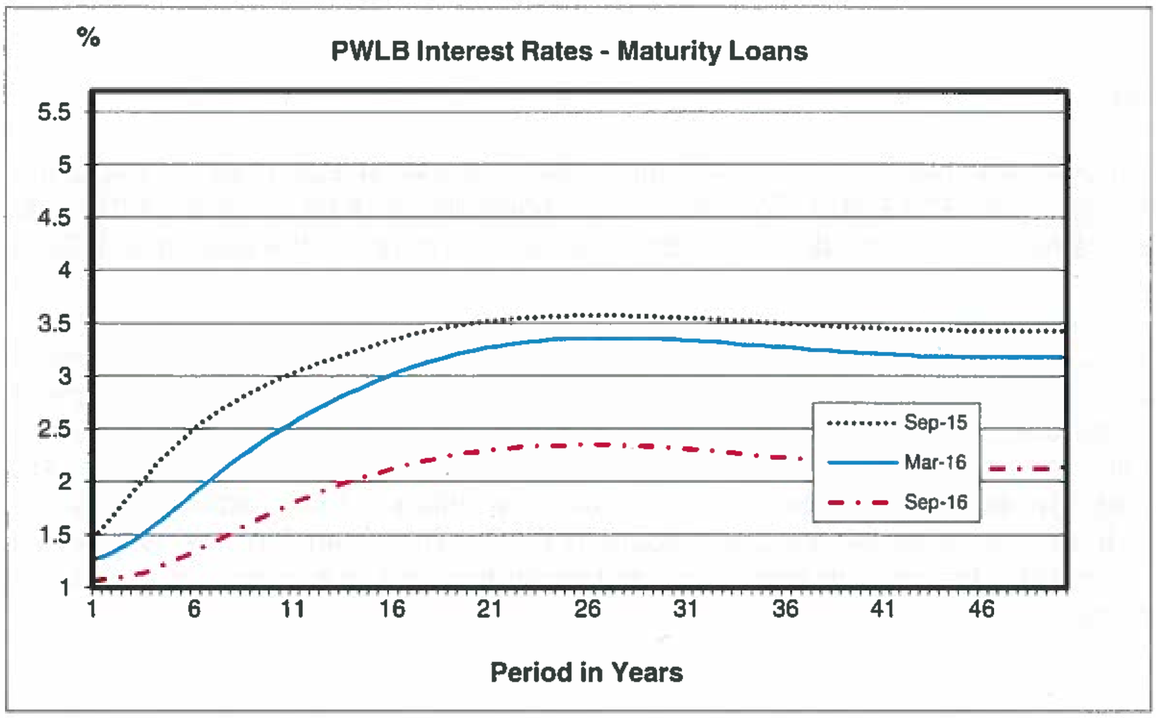
The impact of the new government may also impact on economic conditions. After six years of fiscal consolidation it is seen as likely that the Autumn Statement will include fiscal initiatives to support economic activity. This is most likely to be in the form of infrastructure investment although tax cuts or something similar cannot be ruled out.

Interest Rate Environment

Short term interest rates continue at very low levels with the Bank of England reducing the base rate to 0.25% in August which is the first movement in base rate since March 2009. The graphs below show the latest short term rates and longer term borrowing rates available from the PWLB



Current longer term PWLB rates are shown below.



Outlook for Interest Rates

The table below shows Arlingclose, the County Council's Treasury Management advisors, forecast for interest rates. They consider that over the medium term, economic and political uncertainty will likely dampen investment intentions and tighten credit availability, prompting lower activity levels and potentially a rise in unemployment. In the short term they feel the most likely scenario is for the base rate to remain constant but if there is to be a move it is likely to be a further reduction.

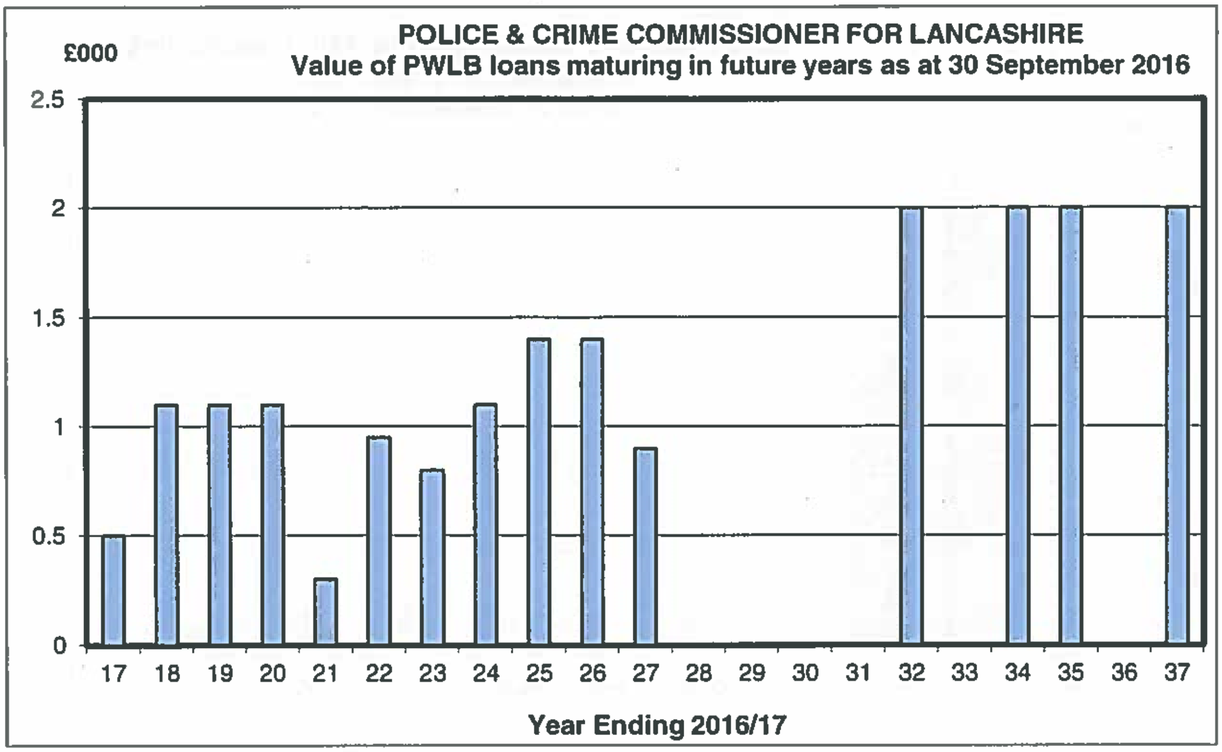
Period	Bank Rate	3 month LIBID	12 month LIBID	20-year Gilt Rate
Q4 2016	0.25	0.25	0.60	1.25
Q1 2017	0.25	0.25	0.50	1.25
Q2 2017	0.25	0.25	0.50	1.25
Q3 2017	0.25	0.30	0.50	1.25
Q4 2017	0.25	0.30	0.50	1.25
Q1 2018	0.25	0.30	0.50	1.25
Q2 2018	0.25	0.30	0.50	1.25
Q3 2018	0.25	0.30	0.60	1.30
Q4 2018	0.25	0.30	0.70	1.35
Q1 2019	0.25	0.30	0.85	1.35
Q2 2019	0.25	0.30	0.90	1.40
Q3 2019	0.25	0.30	0.90	1.40

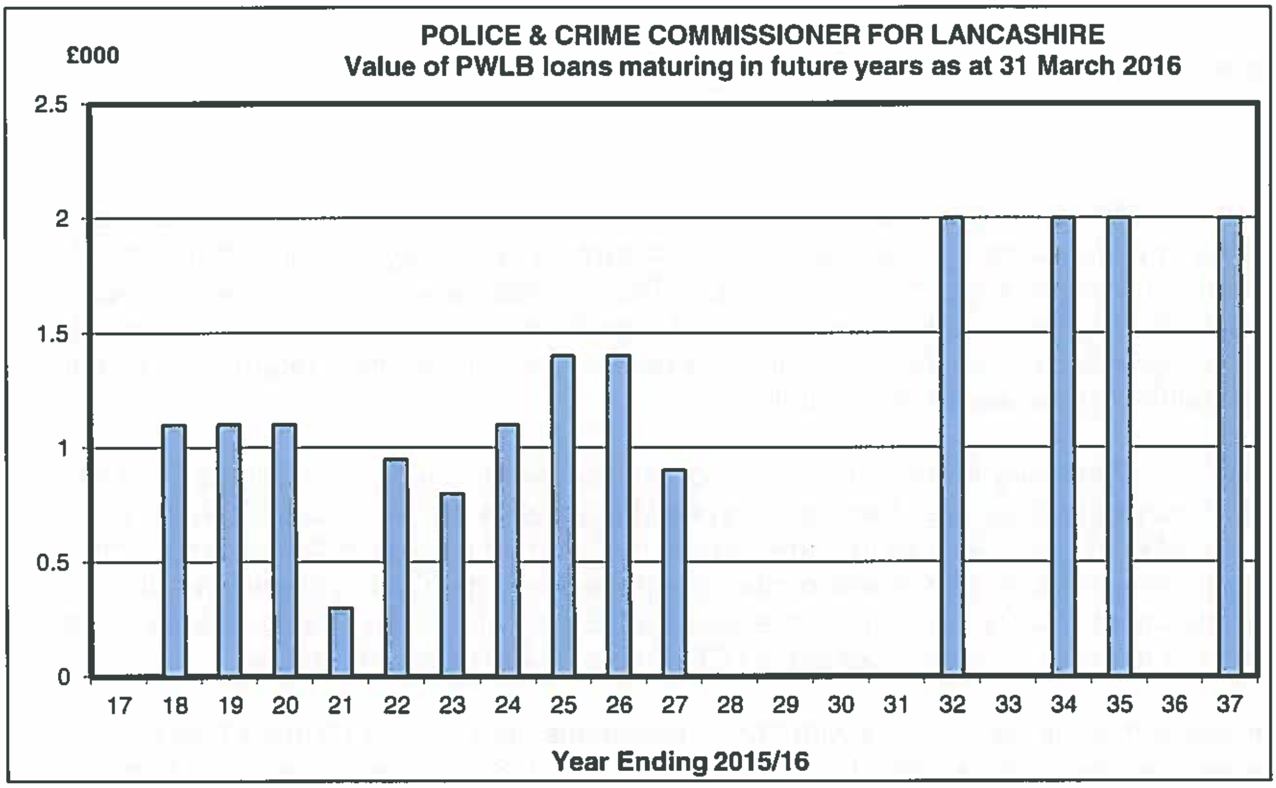
Borrowing

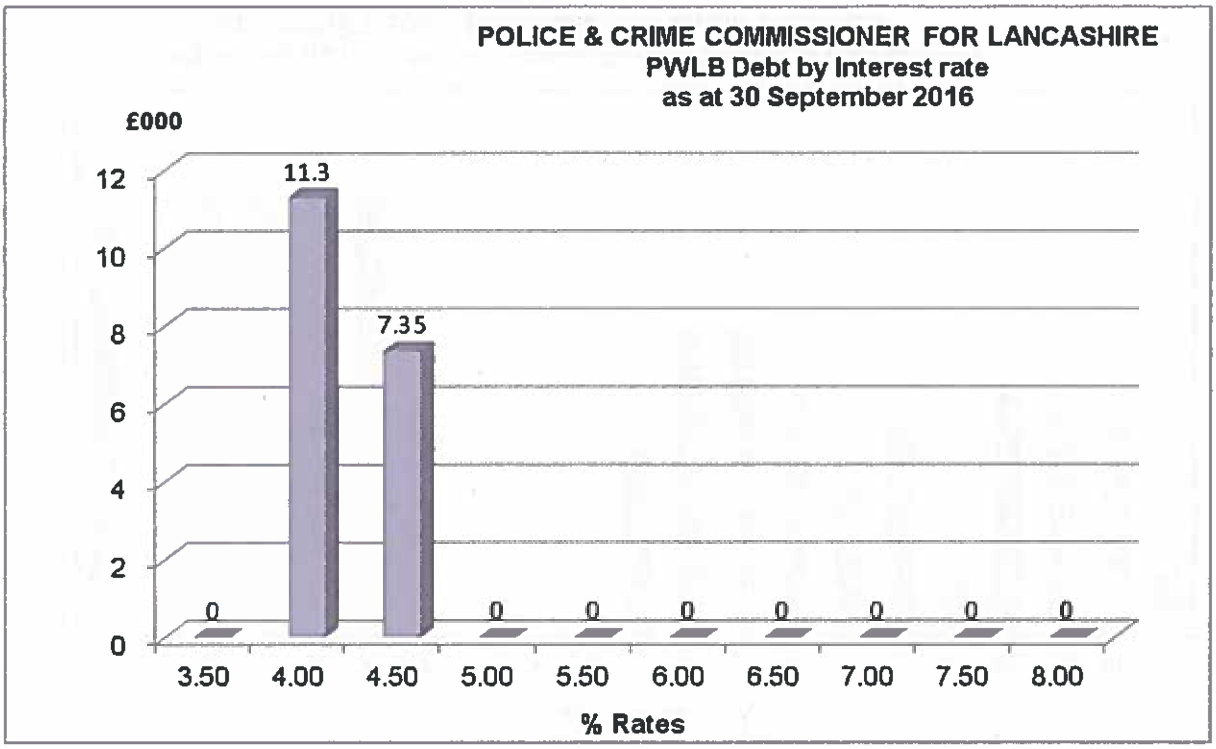
All existing borrowing has been taken with the Public Loans Work Board and at 1 April the debt outstanding was £18.654m. To date no new borrowing has been taken in the year while in September a maturing debt of £0.5m was repaid. Therefore the debt at 30.9.16 is £18.154m.

The current Capital Programme assumes that £7.6m of expenditure will be financed from borrowing in 2016/17. However the PCC has surplus cash balances and at the moment this has been used rather than taking new borrowing. At present the Commissioner's balances are sufficient to cover this internal borrowing and as investment interest rates are at historically low levels internal borrowing is more cost effective than traditional external borrowing from the Public Works Loan Board (PWLB). The Chief Finance Officer will continue to monitor the internal borrowing strategy in the light of economic and interest rate forecasts.

The charts over the page show the current maturity profile of the Commissioner's borrowings, along with an analysis of the debt by interest rate.


POLICE & CRIME COMMISSIONER FOR LANCASHIRE
Value of PWLB loans maturing in future years as at 30 September 2016
£000
2.5
2
1.5
1
0.5
0
17 18 19 20 21 22 23 24 25 26 27 28 29 30 31 32 33 34 35 36 37
Year Ending 2016/17


POLICE & CRIME COMMISSIONER FOR LANCASHIRE
Value of PWLB loans maturing in future years as at 31 March 2016
£000
2.5
2
1.5
1
0.5
0
17 18 19 20 21 22 23 24 25 26 27 28 29 30 31 32 33 34 35 36 37
Year Ending 2015/16



Investments

Both the CIPFA Code and the CLG Guidance require the Commissioner to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Commissioner's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk receiving low investment returns and having the value of reserves eroded by inflation.

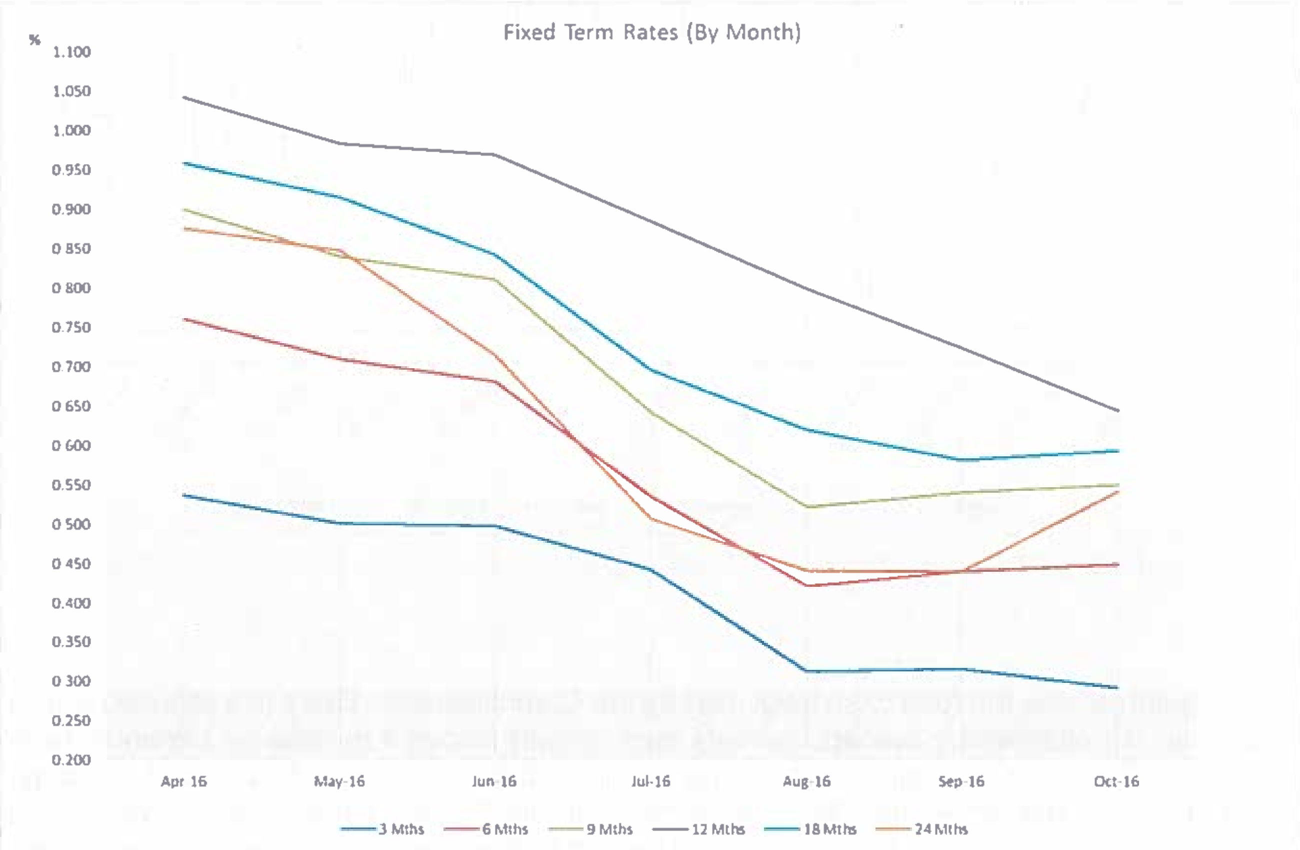
The PCC principally invests in a call account provided by Lancashire County Council which pays the base rate. Each working day the balance on the PCC's Current Account is invested in this to ensure that the interest received on surplus balances is maximised. During the period all new investments were placed with the County Council via this arrangement. At 30th September there was a balance of £42.412m in the call account with the average balance invested in LCC for the period being £42.152 m.

In addition to the call account with LCC investments held at 30.9.16 are a £5m long term investment held with another local authority and £5.038m in a senior secured bond fund. Total investments at 30.9.16 are £52.450m.

The overall combined amount of interest earned on fixed and call balances as at 30th September is £0.120m on an average balance of £52m at an average rate of 0.51%. This compares favourably with the benchmark 7 day notice index which averages 0.43% over the same period.

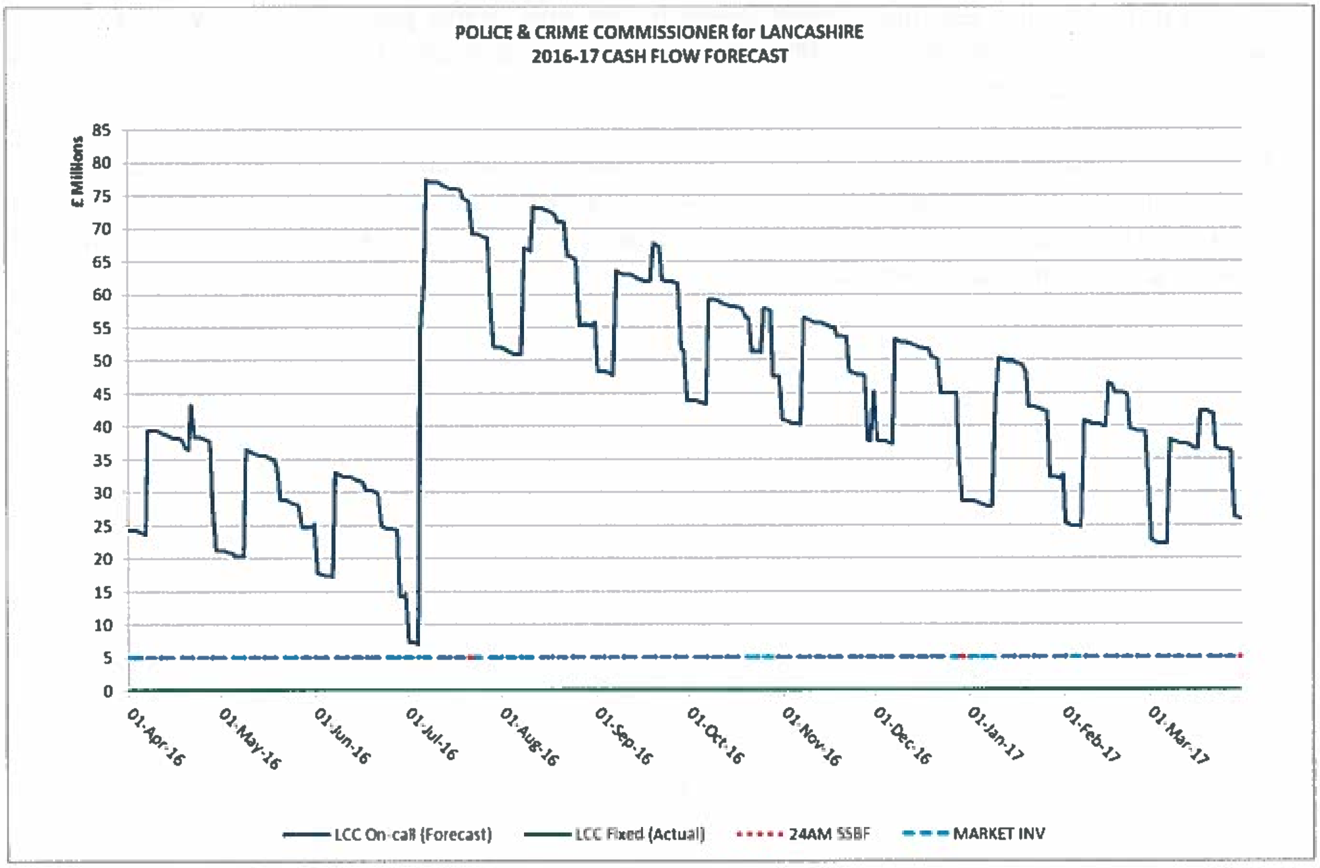
The opportunity to fix investments longer term to generate additional interest income is dependent upon future cash flows. The section below provides information on the cash flow to date and the estimated cash flows to the end of the year. This shows a reducing cash balance but that there is still sufficient cash to consider the opportunity to place a longer term investment .

The chart below shows the current interest rates for different investment maturities. In order to increase the rate earned on current balances, the commissioner would need to place fixed investments of at least 3 months duration but this would be dependent upon a counter party with a sufficient credit rating.



Cash Flow

The estimated cash flow totals are as follows:



This graph shows the total cash level held by the Commissioner. There is a regular pattern as cash is bolstered by precept receipts each month followed by falls as expenditure is incurred. The large cash injection from the low point at the beginning of July is the pensions top up grant. The green line shows how much of the Commissioner's cash is placed on fixed deposit to earn additional interest. The red dotted line shows the Commissioner's investment in the Twenty Four Asset Management senior secured bond fund.

Prudential Indicators

In order to control and monitor PCC's treasury management functions, a number of prudential indicators are determined against which performance may be measured. The indicators for 2016/17 are shown in the table below alongside the current actual and none of the indicators have been breached over the period.

	2016-17 PIs	Actual at 30.9.16
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	39.000	18.154

Other long-term liabilities	1.000	-
Total	40.000	18.154
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 Commissioner's current plans		
Borrowing	36.000	18.154
Other long-term liabilities	1.000	-
Total	37.000	18.154

	2016-17 PIs	**Actual at 30.9.16**
Upper limit for fixed interest rate exposure		
Borrowing	100%	100%
Investments	100%	10%
Upper limit for variable rate exposure		
Borrowing	75%	0%
Investments	100%	90%
Upper limit for total principal sums invested for over 364 days (per maturity date)	75%	Nil
Maturity structure of debt from 31.3.16	**Upper/ Lower Limits**	**Actual**
Under 12 months	50% / nil	3%
12 months and within 24 months	50% / nil	12%
24 months and within 5 years	50% / nil	12%
5 years and within 10 years	80% / nil	30%
10 years and above	90% / 25%	43%

Business Risk Implications

The Treasury Management strategy is designed to minimise the PCC for Lancashire's financial risk associated with investment decisions, whilst maximising the return on any investments made. As such the adoption of the CIPFA's Code of Practice on Treasury Management and the monitoring arrangements in place ensure that any risks faced by PCC are managed.

However, it must be acknowledged that there will always be a balance between risk and return and hence the strategy does not completely eliminate the risk of any further default on investments in the future.

1. **Links to the Police and Crime Plan**

2. **Consultation**

3. **Implications**

    a. **Legal**

    There are no legal comments associated with this paper.

    b. **Financial**

    The financial implications are contained in the report

    c. **Equality considerations**

    There are no Equality comments associated with this paper.

4. **Background Papers**

CIPFA Treasury Management Code of Practice (2011)
PCC for Lancashire Treasury Management Strategy 2016/17

5. **Public access to information**

Information in this form is subject to the Freedom of Information Act 2000 and other legislation.

Part 1 of this form will be made available on the PCC website within 3 working days of approval. Any facts/advice/recommendations that should not be made available on request should not be included in Part 1 but instead on the separate Part 2 form.

Officer declaration	Date
LEGAL IMPLICATIONS – As above	
FINANCIAL IMPLICATIONS – As above	
EQUALITIES IMPLICATIONS – As above	
CONSULTATION – As above	

Director to the Office of the Police and Crime Commissioner (Monitoring Officer)

I have been informed about the proposal and confirm that financial, legal and equalities advice has been taken into account in the preparation of this report. I am satisfied that this is an appropriate request to be submitted to the Police and Crime Commissioner for Lancashire.

Signature...Date............................