Decision No 2013/23

REPORT TO:	**POLICE AND CRIME COMMISSIONER FOR LANCASHIRE**
REPORT BY:	**LISA KITTO, CHIEF FINANCE OFFICER**
DATE:	**10 OCTOBER 2013**
TITLE:	**TREASURY MANAGEMENT 2013/14 MONITORING POSITION**

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

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

APPENDIX A

POLICE & CRIME COMMISSIONER FOR LANCASHIRE

REVIEW OF TREASURY MANAGEMENT 2013/14 Mid Year Report

Issue for Consideration

In accordance with the updated CIPFA Treasury Management code of practice (2011) and to strengthen members' oversight of the Commissioner's treasury management activities, the Police Commissioner receives regular updates on treasury management issues including a mid-year report. Reports on treasury activity are discussed on a quarterly basis with the Chief Finance Officer for PCC and the content of these reports is used as a basis for this report to the Commissioner.

Economic Overview

Global central bank monetary activity has continued to take the fear factor out of international market. Specifically European Central Bank's promise to do whatever was necessary to protect the Euro followed by the US Federal Reserve providing $85bn per month in asset purchases and the Japanese government of Abe San seeking to break 25yrs of economic stagnation with a huge quantitative easing programme, have in combination provided the worldwide financial markets with liquidity on a dramatic scale.

The general effect has been to produce on-going buying of "risk assets" such as Equities, and some early signs of renewed economic activity in particular in the United States. The market, seeing these signs, has already begun to speculate when the need for "Keynesian" support will end, pushing some bond yields higher in advance of the expected return of "normal" interest rates.

Whilst the signs are broadly encouraging, economies do still appear to Central Banks as fragile, indicating that their timetable for rate normalization is still some way off, highlighted by new Governor Carney giving forward guidance on policy rates.

Geo-political factors had, until recently, also shown improvement as day to day crises in Southern Europe abated post bailouts, but the structural issues remain to be dealt with. Elsewhere the expected shift in the balance of the Chinese economy is underway leading to a growth slowdown from the double digit figures of the 1990s and 2000s to an official level of 7.5%. Official statistics are at odds with indicators produced by firms such as HSBC and proxies such as electricity usage, which point to an even sharper GDP slowdown, seemingly borne out by the sharp fall in commodity prices, and the linked fall in some Emerging Markets.

Specifically in the UK non standard monetary policy action such as QE, "Funding for Lending" and government support for the housing market appear to be the corner stones of improving UK statistics. The interbank funding market which had remained very sticky since 2009 has seen substantial falls in funding costs and increases in activity volume and whilst UK banks still have a lot of balance sheet repairing to complete, lending activity has definitely risen. Money supply and velocity is still low but above the contraction levels consistently seen from 2009-2012.

So in conclusion UK economic activity is slowly improving from a very low base. Recovery is fragile and the Bank of England has signalled on-going monetary support at least until 2016. Personal incomes continue to decline as pay rises fail to track inflation, indicating a very high sensitivity to retail interest rates when the eventual base rate moves do come. International risk factors have reduced but have most definitely not gone away as recent events in the Middle East serve to highlight. All of which still suggested that a very conservative credit risk strategy with some inflation protection is still appropriate.

Interest Rate Environment

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 that there has been very little movement in short term interest rates over the first half of the current financial year.

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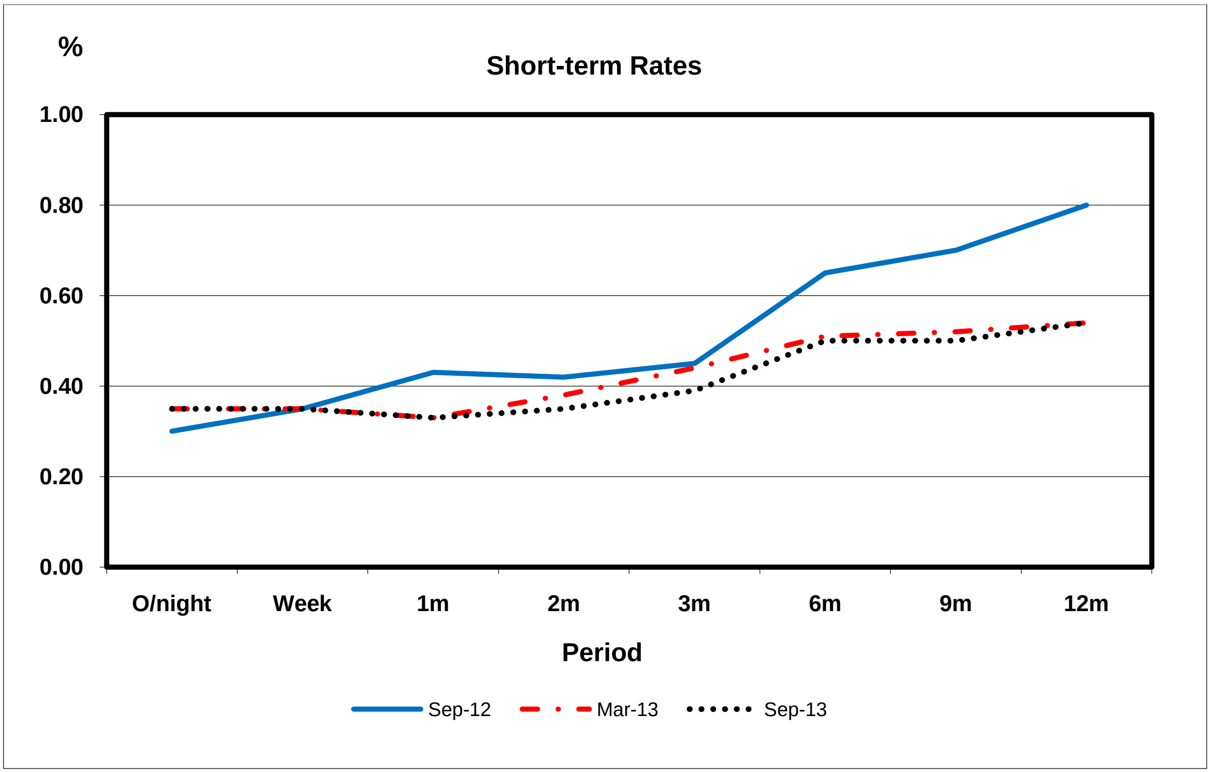
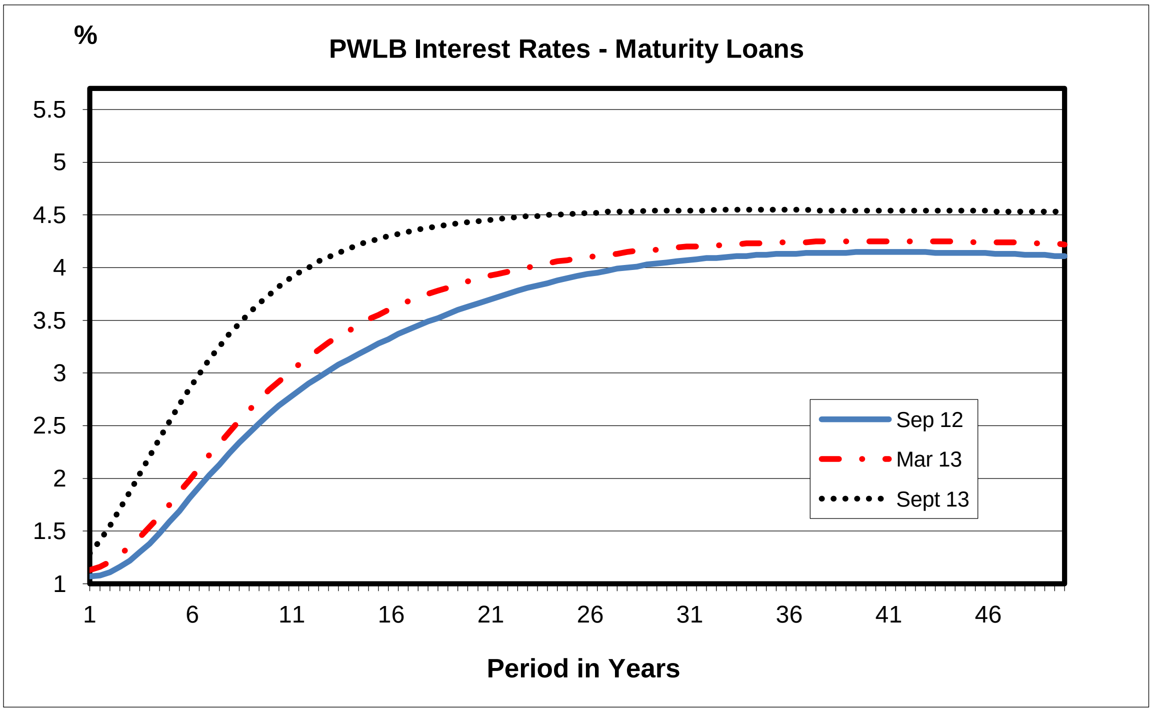


Current longer term PWLB rates are shown below.



Central bank liquidity injections, the abatement of the euro crisis, and the fragile economic recovery has seen a reduction in demand for safe haven assets including UK Government gilts. The result has been an increase in gilt yields and consequently in PWLB interest rates, with a noticeable steepening of the curve in the medium term.

Outlook for Interest Rates

The table below shows a forecast, provided by treasury consultants Arlingclose Ltd. of interest rates over the next three years.

Short term rates are projected to remain flat over this period. Despite the more optimistic economic background short term growth prospects remain subdued. In addition, in his first speech as Governor of the Bank of England Mark Carney, believing that the uncertainty surrounding interest rate rises in recent years had damaged the UK economic recovery highlighted that policy rates would remain low for some years to come as part of the forward guidance policy framework.

Gilt yields are projected to rise steadily through the medium term although downside risks are still present, arising from political instability in Southern Europe and Germany and a recurrence of the Eurozone sovereign debt crisis, events in the Middle East or concern over a possible liquidity crisis in China.

Period	Bank Rate	3 month LIBID	12 month LIBID	20-year PWLB rate
Q3 2013	0.50	0.45	0.90	3.90
Q4 2013	0.50	0.45	0.95	3.95
Q1 2014	0.50	0.50	0.95	4.00
Q2 2014	0.50	0.55	0.95	4.05
Q3 2014	0.50	0.55	1.00	4.10
Q4 2014	0.50	0.55	1.05	4.15
H1 2015	0.50	0.60	1.15	4.30
H2 2015	0.50	0.70	1.20	4.40
H1 2016	0.50	0.80	1.25	4.50
H2 2016	0.50	0.80	1.30	4.70

Borrowing

Since 2008-09 the Police & Crime Commissioner for Lancashire 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..

	2012-13	**2013-14**	**2014-15**
	Actual	**Estimate**	**Estimate**
	£m	**£m**	**£m**
Capital Programme Borrowing	1.207	4.195	10.765
Borrowing requirement b/fwd from previous year	14.113	16.444	20.246
Maturing Debt	2.500	1.000	1.000
Less Statutory MRP (PWLB only @ 4%)	-1.376	-1.393	-1.393
Total Borrowing Requirement	**16.444**	**20.246**	**31.618**

All of PCC's borrowing is from the Public Works Loan Board. Following a scheduled debt repayment in 2013 the current long term debt outstanding is £21.154m. The next scheduled repayment is in the 2014-15 financial year. It is possible to repay debt early but the PWLB will charge a premium for early repayment loss of interest.

	2012-13	**2013-14**	**2014-15**
	Actual	**Estimate**	**Estimate**
	£m	**£m**	**£m**
Total Debt Outstanding	**23.654**	**21.154**	**20.154**
In year debt repayment	-2.500	-1.000	-1.000
New Borrowing	-	-	-
Total Debt Outstanding	**21.154**	**20.154**	**19.154**

Investments

In line with the 2013-14 treasury management strategy which continues the policy of credit risk reduction following the financial crisis, Lancashire County Council (credit rating by Moodys AA2) is the counterparty for all of PCC's investments

The Commissioner 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 Chief Finance Officer for PCC and the Lancashire County Council Treasury Management Team. All investments are made in accordance with the current Treasury Management Strategy and the CIPFA treasury management code of practice.

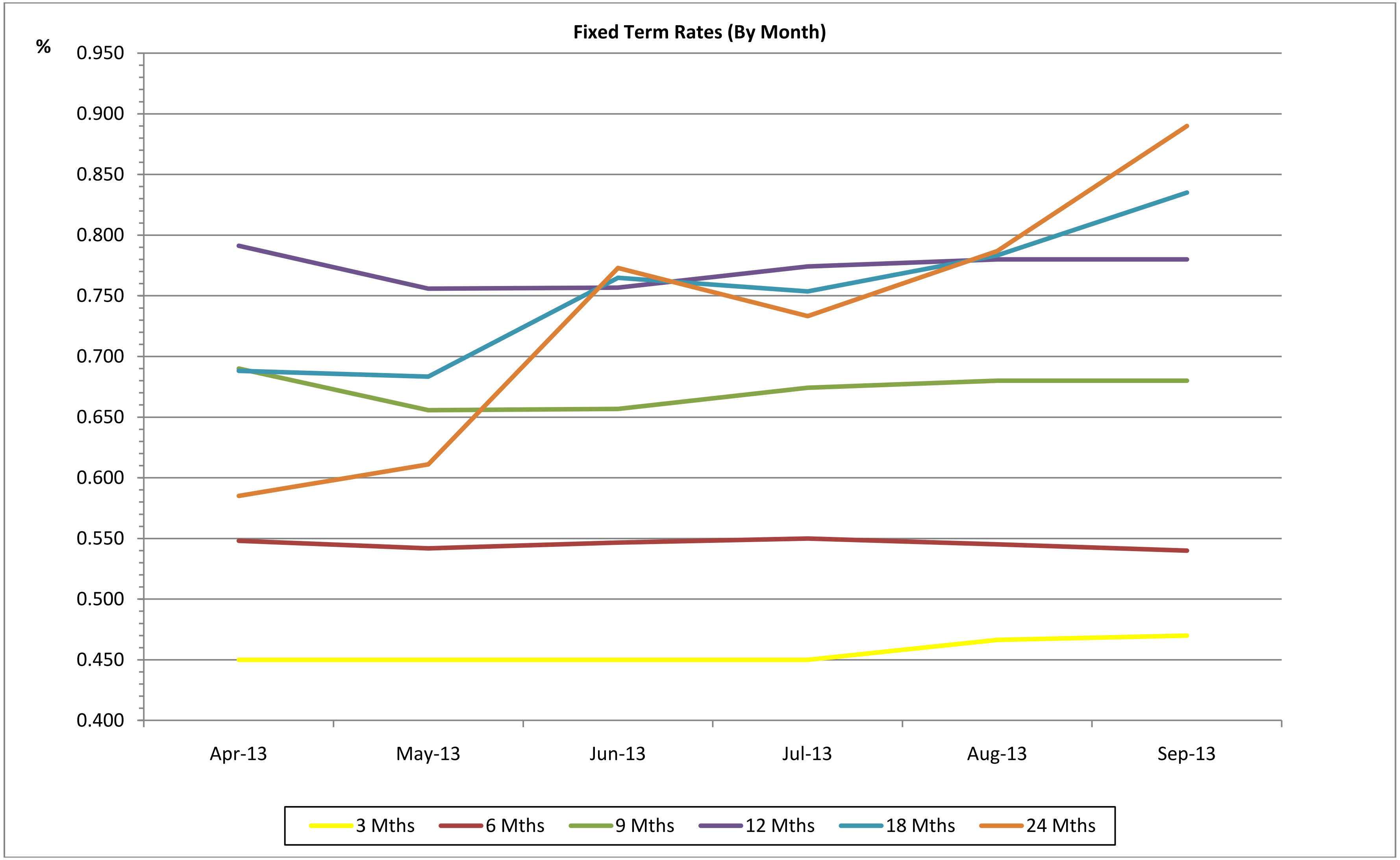
The Commissioner has access to a call (instant access) account, which pays 20 basis points (0.20%) above bank rate, this is currently 0.70%. Each working day the balance on the Commissioner's Current Account is invested in this to ensure that the interest received on surplus balances is maximised.

In addition the Commissioner for Lancashire is able to make specific investments with LCC at any time and currently has the following investment.

INV Number	Start Date	Maturity Date	Amount £M	Duration	Interest Rate	Interest on Maturity
PCC8	03/07/2013	30/06/2014	£10m	362 days	0.76%	£75,375

The overall combined amount of interest earned on Fixed/Call balances as at 31st August 2013 is £142.3k on an average balance of £36m at an average rate of 0.95%. The current interest rate is 0.71% following the investment of the above fixed term deposit. Average rate compares favourably with the benchmark 7 day notice index which averages 0.44% over the same period.

The chart below shows the current interest rates for different investment maturities with 3mth, 6mth and 9mth fixed rates falling below PCC for Lancashire's call rate, which is currently 0.70%



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 2013/14 are shown in the table below alongside the current actual and none of the indicators have been breached over the period.

	2013-14 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

	2013-14 PIs	**Actual to Date**
Upper limit for fixed interest rate exposure		
Borrowing	100%	100%
Investments	100%	24%
Upper limit for variable rate exposure		
Borrowing	25%	0%
Investments	100%	76%
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	4.73%
12 months and within 24 months	50% / nil	7.09%
24 months and within 5 years	50% / nil	12.76%
5 years and within 10 years	80% / nil	20.11%
10 years and above	90% / 25%	55.31%

Icelandic Banks

At the time the Icelandic banks collapsed in October 2008, the County Council had an investment of £10.0m with Landsbanki. Under the treasury management strategy in operation at that time, the Authority's share of the deposit with Landsbanki was £0.668m.

Since then 4 distributions have been received, the most recent on 12^{th} September 2013. These distributions total £355,441 and whilst the reminder of the balance is expected at some point in the future, the timing and amounts of future distributions is not known at this stage.

A number of market participants have recently shown an interest in buying priority creditor claims in the failed Icelandic banks. In addition the Local Government Association and their legal advisors, Bevan Brittan, are looking at the possibility of organising a group sale in the hope of achieving a higher price and reducing trading expenses. All options are being considered for the recovery of the funds in Iceland, including the sale of the claim, but at present none of the offers received have been high enough to warrant the sale of the claim.

Human Resource Implications
None

Financial Implications
None

Business Risk Implications

The Treasury Management strategy is designed to minimise PCC for Lancashire 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.

Decision Required
The crime commission are asked to note the report

Background Papers

I. CIPFA Treasury Management Code of Practice (2011)
II. Lancashire Police Authority Treasury Management Strategy 2013/14

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