2015/28

JOINT MANAGEMENT BOARD

ITEM 2	DATE: 7 AUGUST 2015
TITLE: 2014/15 TREASURY MANAGEMENT YEAR-END POSITION	
REPORT BY: STEVE FREEMAN – CHIEF FINANCE OFFICER ANDY ORMEROD – SENIOR INVESTMENT OFFICER	

Executive Summary

This report sets out the Commissioner's borrowing and lending activities during 2014/15. All borrowing and investment activities undertaken throughout the year are in accordance with the 2014/15 Treasury Management Policy and based on anticipated spending and interest rates prevailing at the time.

Recommendation

The Police and Crime Commissioner is asked to note and endorse the outturn position report

Signature Clive Grunshaw

Police and Crime Commissioner

Date 7th August 2015.

PART I

1. Background and Advice

1.1. In accordance with the CIPFA Treasury Management Code of Practice (2011) and to ensure oversight of treasury management activity, the Commissioner receives regular updates on treasury management issues including a mid-year report and a final outturn report on performance. This report sets out the Commissioner's borrowing and lending activities during 2014/15.

2. Economic Background

2.1. Gross Domestic Product (GDP) growth of 3% in 2014 was indicative of a more positive outlook for the UK economy as a result of a buoyant services sector, supplemented by positive contributions from the production and construction sectors.

2.2. Annual Consumer Price Index (CPI) inflation fell to zero for the year to March 2015, down from 1.6% a year earlier. The key driver was the fall in the oil price (which fell to its lowest level since March 2009) and a steep drop in wholesale energy prices; extra momentum came from supermarket competition resulting in lower food prices. Bank of England Governor Mark Carney wrote an open letter to the Chancellor in February, explaining that the Bank expected CPI to temporarily turn negative but to increase around the end of 2015 as the lower prices dropped out of the annual rate calculation. The UK labour market also continued to improve with January 2015 showing the rate of unemployment falling to 5.7% from 7.2% a year earlier.

2.3. The Bank of England's Monetary Policy Committee (MPC) maintained interest rates at 0.5% and asset purchases (Quantitative Easing) at £375bn. The minutes of the MPC meetings reiterated the Committee's stance that the economic outlook for the UK economy meant that increases in the Bank Rate would be gradual and limited.

2.4. Political uncertainty had a large bearing on market confidence this year. The possibility of Scottish independence was of concern to the financial markets, however this dissipated following the outcome of September's referendum. The risk of upheaval (the pledge to devolve extensive new powers to the Scottish parliament and English MPs in turn demanding separate laws for England) lingers on. A closely contested general election campaign led to the markets bracing for a hung parliament.

2.5. On the continent, the European Central Bank (ECB) lowered its official benchmark interest rate from 0.15% to 0.05% in September and the rate paid on commercial bank balances held with it was lowered from -0.10% to -0.20%. The much-anticipated quantitative easing, which will expand the ECB's balance sheet by €1.1 trillion was finally announced by the Central Bank at its January meeting in an effort to steer the euro area away from deflation and stimulate economies. This involves buying €60bn of sovereign bonds, asset-backed securities and covered bonds a month commencing

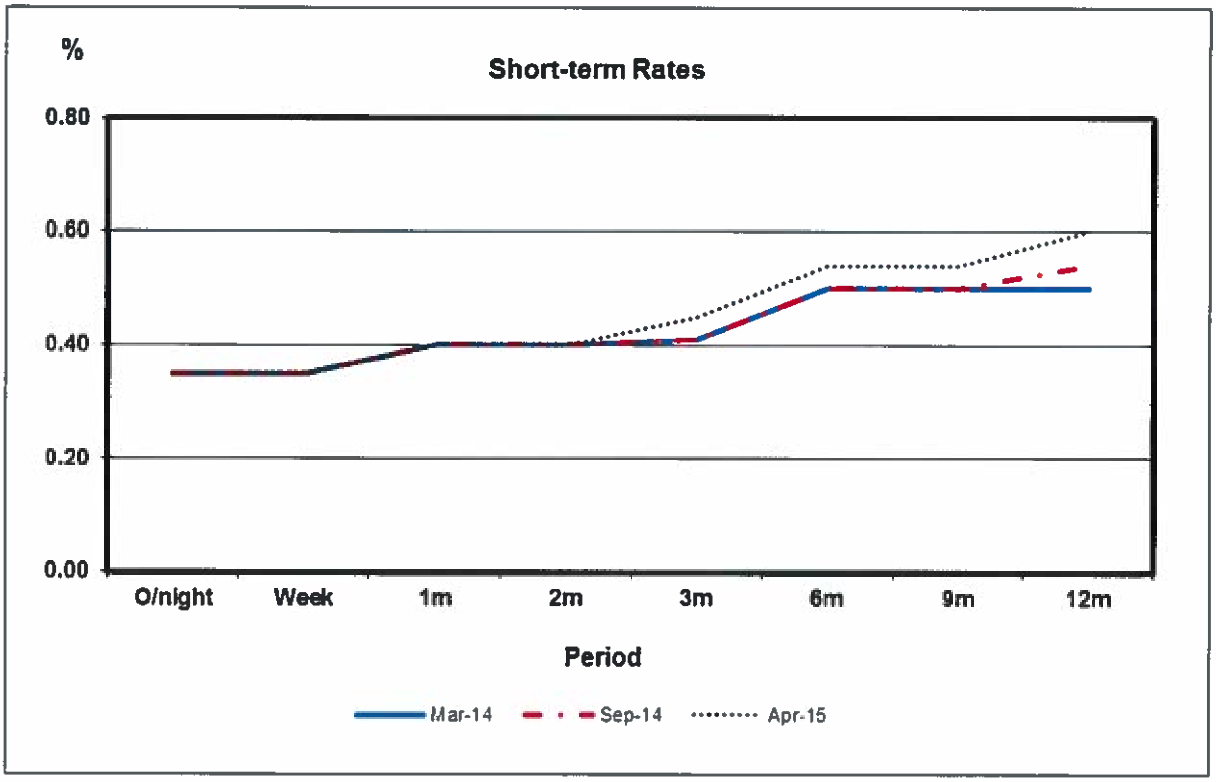
March 2015 through to September 2016. The possibility of a Greek exit from the Eurozone refused to subside given the clear frustrations that remained between its new government and its creditors.

2.6. The US economy performed strongly in 2014, employment growth was robust and there were early signs of wage pressures building, albeit from a low level. The Federal Reserve made no change to US policy rates. The central bank however continued with 'tapering', i.e. a reduction in asset purchases by $10 billion per month, and ended them altogether in October 2014. With the US economy resilient enough to weather the weakness of key trading partners and a strong US dollar, in March 2015 the Fed removed the word "patient" from its statement accompanying its rates decisions, effectively leaving the door open for a rise in rates later in the year.

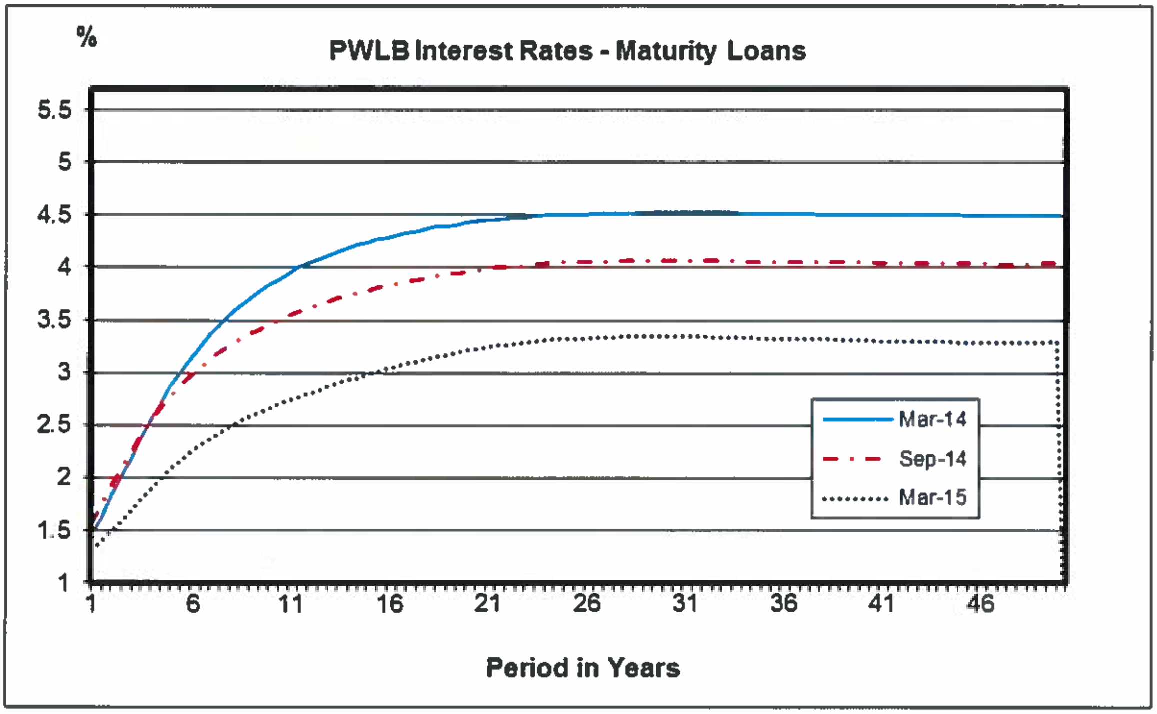
2.7. Against this economic backdrop, from July gilt yields were driven lower by geo-political risks emanating from the Middle East and Ukraine, the slide towards deflation within the Eurozone and the big fall in the price of oil and its transmission though into lower prices globally. 5-, 10- and 20-year gilt yields fell to their lows in January (0.88%, 1.33% and 1.86% respectively) before ending the year higher at 1.19%, 1.57% and 2.14% respectively.

3. Interest Rate Environment

3.1. Short term interest rates continue at very low levels since the Bank of England reduced the base rate to 0.5% in March 2009. The 3-month, 6-month and 12-month Libid rates, which reflect short term investment levels, remained below 0.6% through the year as illustrated in the chart below.



3.2. Regarding long term rates the chart below shows how PWLB rates fell during the year in line with the falling gilt yields described above.



3.3. A revised forecast of interest rates, published recently by Lancashire County Council's treasury management advisors Arlingclose Treasury Consultants is shown below. (Note that the Quarter and Half years referred to are calendar years, as opposed to financial years).

Period	Bank Rate	3 month LIBID	12 month LIBID	20-year PWLB rate
Q2 2015	0.50	0.55	0.90	3.05
Q3 2015	0.50	0.55	0.95	3.05
Q4 2015	0.50	0.55	1.00	3.05
Q1 2016	0.50	0.60	1.20	3.15
Q2 2016	0.75	0.80	1.35	3.20
Q3 2016	0.75	0.95	1.45	3.25
Q4 2016	1.00	1.05	1.55	3.30
H1 2017	1.00	1.20	1.70	3.40
H2 2017	1.25	1.40	1.95	3.50
H1 2018	1.50	1.60	2.10	3.60

3.4. The first rise in official interest rates is forecasted for Q2 2016 but the long held theme of low for even longer still remains.

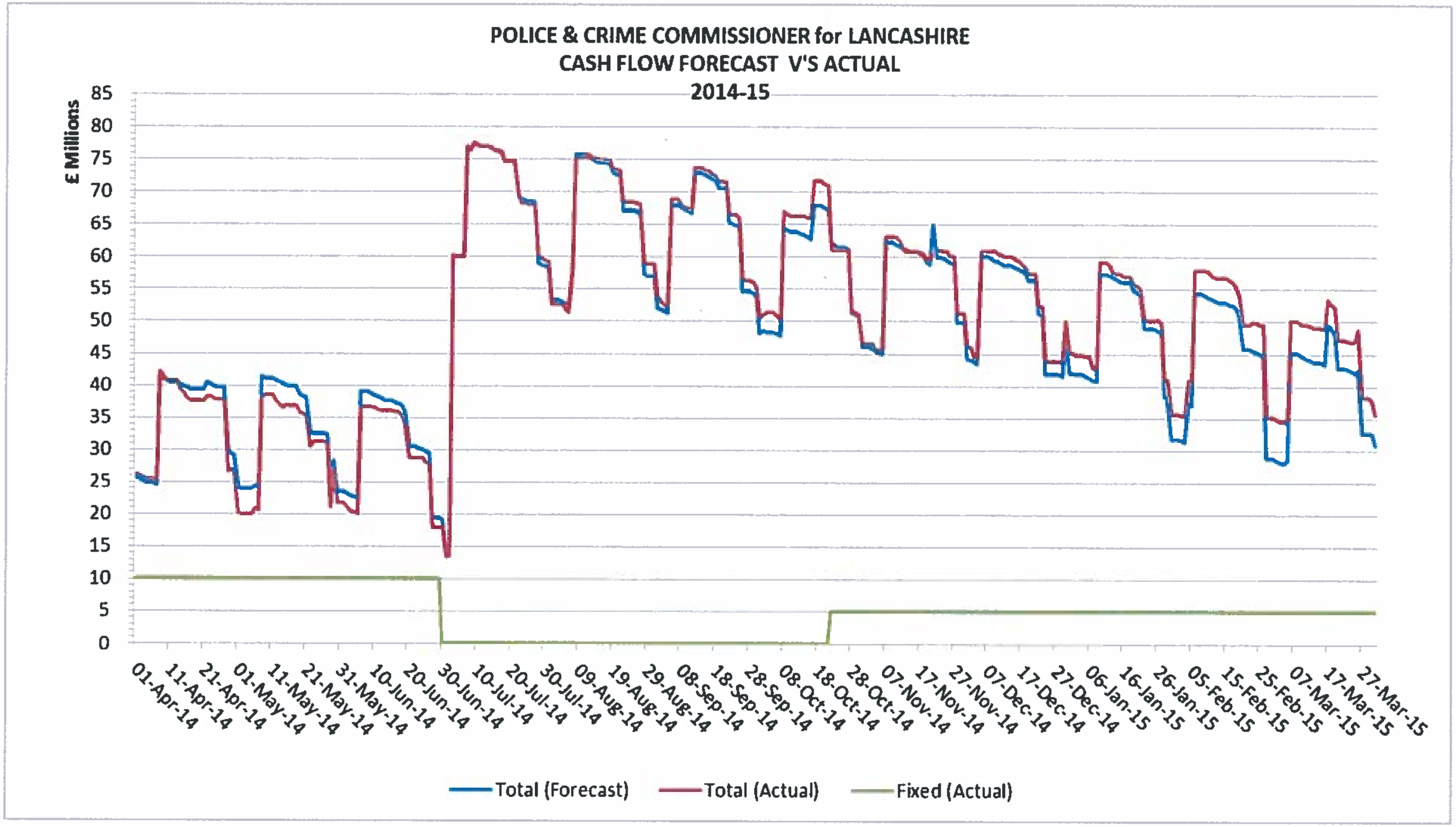
4. Cash Flow

4.1. Cash flow predictions are made on a rolling basis in order to ensure that the PCC for Lancashire has sufficient funds to meet its day to day requirements and also inform investments and borrowing decisions.

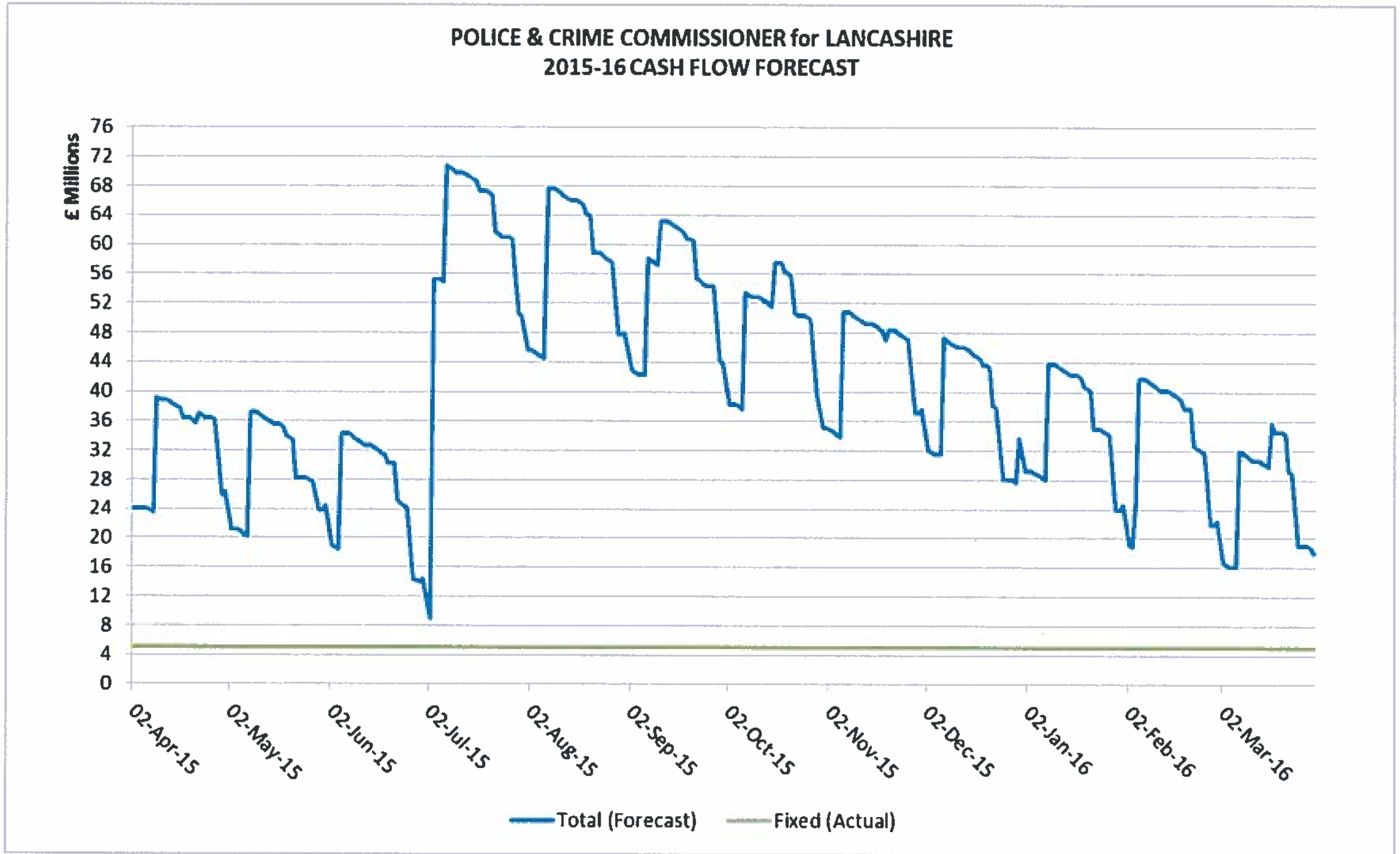
4.2. The cash flow position along with the interest rate environment form part of the regular discussions between the Chief Finance Officer and Lancashire

County Council Treasury Management Team, in order to inform future decisions on borrowing and investments.

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



The following graph shows estimated long term cash flow projections:



5. Borrowing

5.1. After finalisation of the capital out-turn for 2014/15, the outstanding borrowing requirement and the total amount of long term borrowing is set out below:-

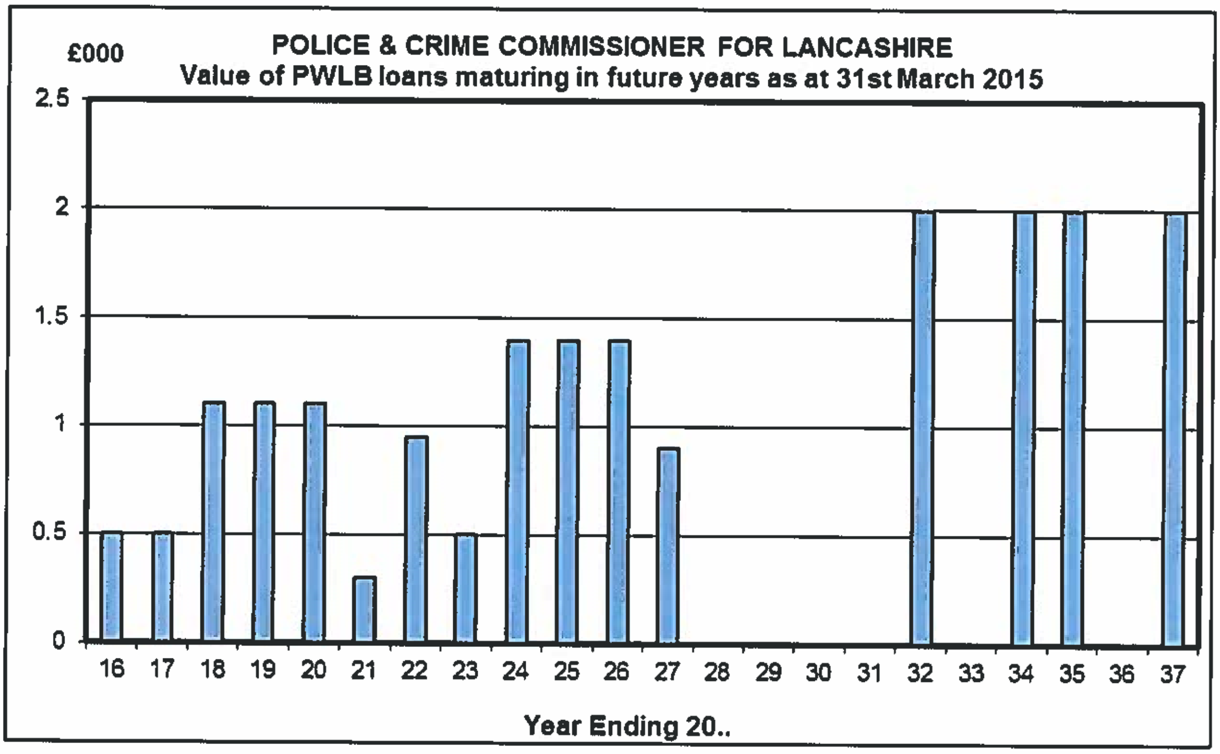
	2014-15	2014-15
	Revised	**Actual**
	Forecast	**31.3.15**
	£m	**£m**
Total Debt Outstanding 1st April	**20.154**	**20.154**
Capital Programme Borrowing	0.600	0.151
Borrowing requirement b/fwd from previous year	20.273	20.273
Maturing Debt	1.000	1.000
Less MRP	-1.311	-1.326
Total Borrowing Requirement	**20.562**	**20.098**
In year debt repayment	1.000	1.000
Total Debt Outstanding 31st March	**19.154**	**19.154**

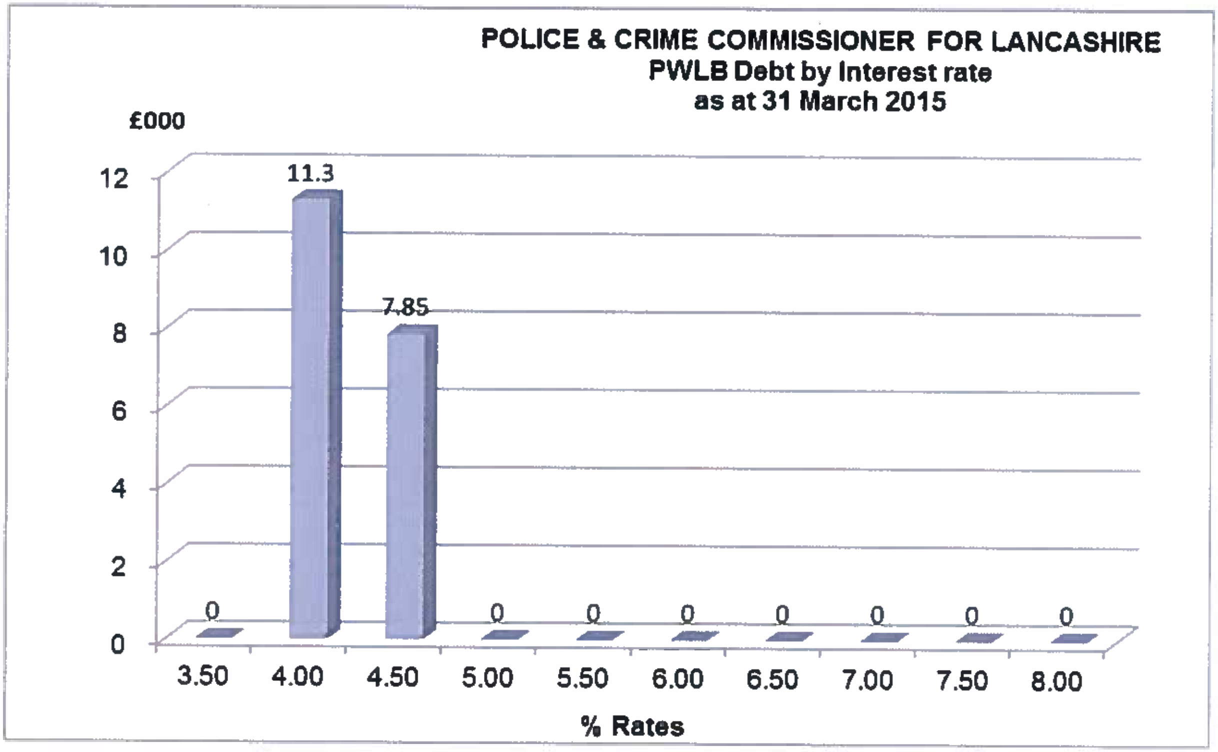
5.2. The minimum revenue provision (MRP) is charged to the revenue account to repay debt. The PCC is required to calculate a prudent MRP giving consideration to guidelines issued by the Government.

5.3. The PCC's cash investments remain significantly in excess of borrowing requirements and hence to avoid excess borrowing and in order to reduce credit rate risk it has continued its policy of utilising balances to fund capital programme expenditure. Therefore no new borrowing has been taken out in the year, and as such long term borrowing currently stands at £19.154m. The outstanding borrowing requirement at the year-end is £20.098m and this will be carried forward and added to future years borrowing requirements for consideration alongside the future years' capital programme.

5.4. The borrowing requirement carried forward has been growing annually over the past 5 years as successive capital expenditure has been funded from internal rather than external borrowing. The assumption that this borrowing will be taken externally at some point in the future is not necessarily true, and given the relatively large size of the carried forward borrowing requirement it is now proposed to review the appropriateness of this figure within the context of the next review of the capital programme.

5.5. The charts below show the current maturity profile and interest rate profile against borrowings.



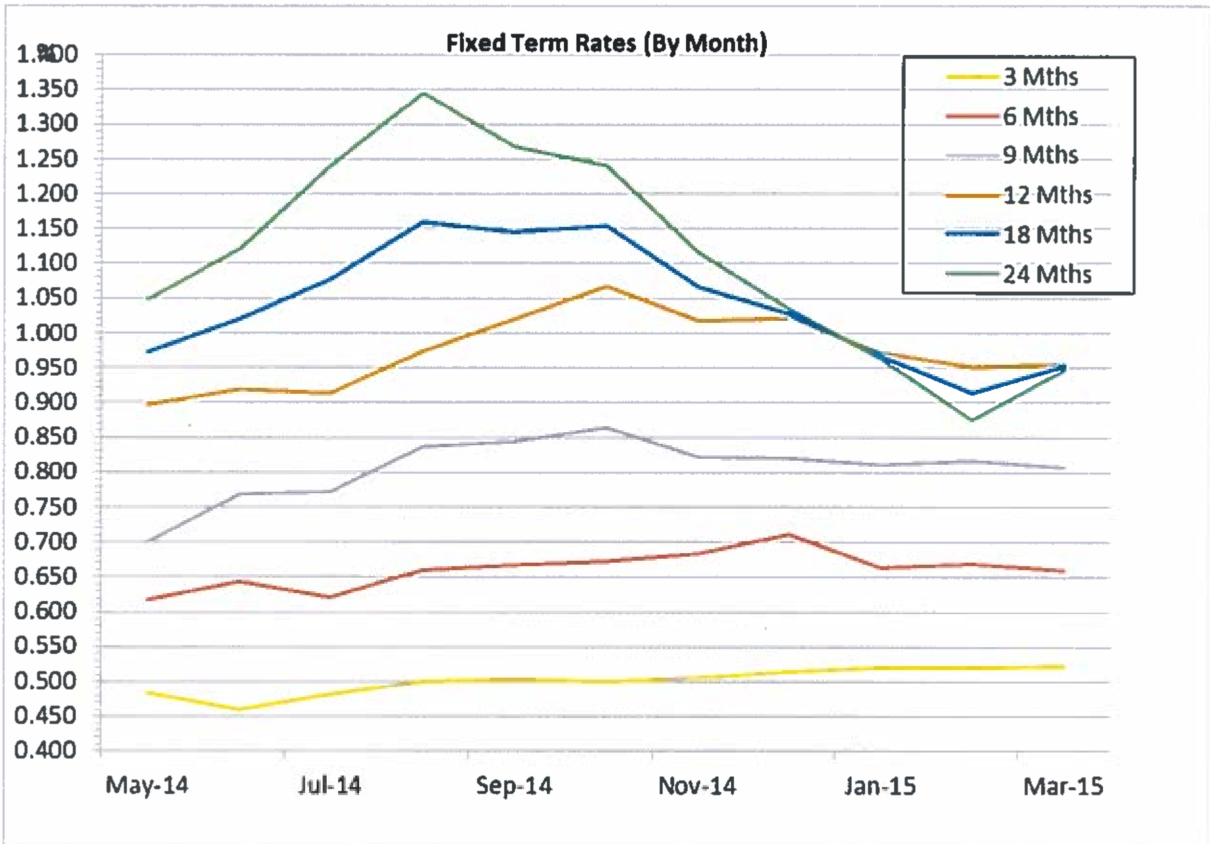


5.6. Total interest payable on borrowing during 2014/15 is £896.4k, which equates to an average interest rate of 4.45%.

6. Investments

6.1. For a number of years following the financial crisis of 2008, in order to reduce the Commissioner's credit risk, Lancashire County Council (credit rating by Moodys Aa2) was the counterparty for all of the CCP's investments. However this counterparty list was expanded in the 2014/15 treasury management strategy to include other high quality counterparties.

6.2. Both the CIPFA Code and the CLG Guidance require the PCC to invest funds prudently, and to have regard to the security and liquidity of investments before seeking the highest rate of return, or yield. The PCC'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 unsuitably low investment income. The chart below shows the current interest rates for different investment maturities.



6.3. The re-addition of the other counterparties into the investment policy is intended to improve investment returns whilst retaining the very high credit quality of the portfolio.

6.4. In accordance with this policy, when a short term fixed loan to the county council matured at the end of June (with £18,740 interest) it was replaced with a long term loan with another UK local authority as outlined below. The PCC managed to place £5m of fixed deposits as the longer term rates spiked in the summer of 2014.

Start Date	End Date	Principal	Rate	Annual Interest	Interest 2014/15
22/10/14	23/10/17	£5,000,000	1.5%	£75,000	£33,082

6.5. In addition to these the Commissioner had access to the call account provided by Lancashire County Council which paid 20 basis points above base rate throughout 2014/15. 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. The average balance in this account during the year was £48.381m accruing interest of £339k.

6.6. The overall interest earned during this period was £390k at a rate of 0.74% which compares favourably with the benchmark 7 day notice index which averages 0.43% over the same period.

6.7. The PCC managed to place £5m of fixed deposits as longer term rates spiked in the summer of 2014.

6.8. All of these investments are made in accordance with the current Treasury Management Strategy and the CIPFA treasury management code of practice.

6.9. Cash flow and interest rates continue to be monitored by the Director of Corporate Services and the County Council's treasury management team, and when rates are felt to be at appropriate levels further term deposits will be placed.

7. Icelandic Banks

7.1. The PCC for Lancashire inherited a position from the Police Authority that had £0.410m on deposit with the Icelandic Bank Landsbanki Is. when it collapsed in October 2008. The Authority 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. Since then the Winding Up Board has made a number of distributions and through the final sale of the remaining claim 91% of the claim has been recovered. The PCC no longer have any claim against the assets of the Icelandic Bank.

7.2. A summary of the final situation is shown below:

	£m	£m
Total Claim		
Principal	0.668	
Interest	0.010	0.678
Total Recovered		
Distributions 2011 to 2013	0.355	
Sale 2014/15	0.263	0.618
Final Loss		0.060

7.3. The Icelandic investment was impaired in the Commissioner's accounts at the time of the bank's collapse. Because this impairment was estimated at the time to be higher than the actual loss turned out to be, the full amount of this loss has already been charged to revenue in previous years. Reversing the surplus amount of the impairment provision means a gain of £47k has been brought into the revenue account in 14/15.

8. Prudential Indicators

8.1. In order to control and monitor PCC for Lancashire 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 actual outturn position.

	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	46.000	19.154
Other long-term liabilities	1.000	-
Total	47.000	19.154
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 PCC's current plans		
Borrowing	43.000	19.154
Other long-term liabilities	1.000	-
Total	44.000	19.154
	2013-14 PIs	**Actual to Date**
Upper limit for fixed interest rate exposure		
Borrowing	100%	100%
Investments	100%	12.33%
Upper limit for variable rate exposure		
Borrowing	25%	Nil
Investments	100%	87.67%
Upper limit for total principal sums invested for over 364 days (per maturity date)	75%	12.33%
Maturity structure of debt	**Upper/ Lower Limits**	**Actual to Date**
Under 12 months	50% / nil	Nil
12 months and within 24 months	50% / nil	7.44%
24 months and within 5 years	50% / nil	13.40%
5 years and within 10 years	80% / nil	21.11%
10 years and above	90% / 25%	58.05%

9. Implications

9.1. Financial

The following table summarises the Financing costs for the PCC, comparing actual with budget:-

	Budget	Actual	Reason for variance
Interest Payable on PWLB loans and transferred debt	£1.389m	£0.926m	Lower than anticipated borrowing leads to lower interest charges.
Interest Receivable on call and fixed term investments	(£0.429m)	(£0.442m)	Increased investment return as some investments placed for longer period.
Minimum Revenue Provision re PWLB loans	£1.366m	£1.366m	In line with budget.
Net financing costs from Treasury Management activities	£2.326m	£1.850m	£0.476m favourable variance.

9.2. Human Resource

None

9.3. Equality and Diversity Implications

None

9.4. Business Risk Implications

The Treasury Management Strategy is designed to maximise interest earned, minimise interest paid whilst maintaining an acceptable level of risk. The reviews of performance provide members with an assurance that this has been complied with.

9.5. Environment

None

10. Links to the Police and Crime Plan

10.1. Treasury management supports the Commissioner's commitment to ensure the efficient use of public funds.

11. Consultation

12. Background Papers

I. CIPFA – Treasury Management Code of Practice – 2011 Edition
II. Treasury Management Strategy 2013/14

13. 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............................