Decision No. 2018/25

REPORT TO: Police and Crime Commissioner for Lancashire

REPORT BY: Steve Freeman
Chief Finance Officer

DATE: 23 July 2018

TITLE: 2017/18 Treasury Management year-end position

Appendix A refers

Contact for further information:
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Executive Summary

This report sets out the Commissioner's borrowing and lending activities during 2017/18. All borrowing and investment activities undertaken throughout the year are in accordance with the 2017/18 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

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: Clive Grunshaw **Police and Crime Commissioner** **Date:** 24th July 2018	**Signed:** **Chief Officer:** **Date:** 24/7/18
Signed: **Chief Constable** **Date:**	**Signed:** **Chief Finance Officer:** **Date:** 24/7/18

2017/18 Treasury Management year-end position

Introduction

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. This report sets out the Commissioner's borrowing and lending activities during 2017/18.

Economic Background

Treasury Management activity is influenced by the actual and forecast economic position. During 2017/18 the UK economy showed signs of slowing economic growth with latest estimates showing GDP grew by 1.8% in calendar 2017, the same level as in 2016. Although this was a far better outcome than the majority of forecasts following the EU Referendum in June 2016, it reflected the impact of the international growth momentum generated by the increasingly buoyant US economy and the re-emergence of the Eurozone economies.

The year saw an increase in inflation with the Consumer Prices Index (CPI) rising to 3.1% in November partly due to the impact of the falling exchange rate before falling back to 2.7% in February 2018. Data on the unemployment rate was positive with the rate falling to 4.3% in January. However there still remained concerns over the strength of the economy. Average real earnings growth, i.e. after inflation, turned negative before slowly recovering which indicates a potential weakness in consumer spending an important source of economic growth. Also, there is a weakness in UK business investment which was not helped by political uncertainty following the surprise General Election in June and by the lack of clarity on Brexit. Although the UK and the EU reached an agreement in March 2018 on a transition which will go up to Q4 2020 there is still significant uncertainty over the long term trade arrangements.

With concerns over inflation being above its target The Bank of England's Monetary Policy Committee (MPC) increased the Bank Rate by 0.25% in November 2017. This was the first rate hike in ten years, although in essence the MPC reversed its August 2016 cut following the referendum result. The February Inflation Report indicated the MPC was keen to return inflation to the 2% target over a more conventional (18-24 months) horizon and indicated there would be 'gradual' and 'limited' increases in rates.

However, there is still uncertainty in the economy which could impact on the policy. The imposition of tariffs on a broadening range of goods initiated by the US, which has led to retaliation by China, could escalate into a deep-rooted trade war having broader economic consequences including inflation rising rapidly, warranting more interest rate hikes.

Credit background

The rules for UK banks' ring-fencing were finalised by the Prudential Regulation Authority and banks began the complex implementation process ahead of the statutory deadline of 1st January 2019. Under these rules the largest UK banks will be required to separate their retail banking services to individuals and small businesses from their investment banking activities with the retail bank being referred to as the ring fenced bank. As there was some uncertainty surrounding which banking entities the Authority would be dealing with once ring-fencing was implemented and what the balance

sheets of the ring-fenced and non ring-fenced entities would actually look like, in May 2017 Arlingclose advised adjusting downwards the maturity limit for unsecured investments to a maximum of 6 months. The rating agencies had slightly varying views on the creditworthiness of the restructured entities.
Barclays was the first to complete its ring-fence restructure over the 2018 Easter weekend; wholesale deposits including local authority deposits will henceforth be accepted by Barclays Bank plc (branded Barclays International), which is the non ring-fenced bank.

Credit Rating developments

The most significant change was the downgrade by Moody's to the UK sovereign rating in September from Aa1 to Aa2 which resulted in subsequent downgrades to sub-sovereign entities including local authorities.

Other developments:

In February, Arlingclose advised against lending to Northamptonshire County Council (NCC). NCC issued a section 114 notice in the light of severe financial challenge and the risk that it would not be in a position to deliver a balanced budget. This guidance has now been revised to "Arlingclose is now comfortable with clients lending to Northamptonshire County Council for treasury management purposes for a maximum duration of 12 months"

Interest Rate Environment

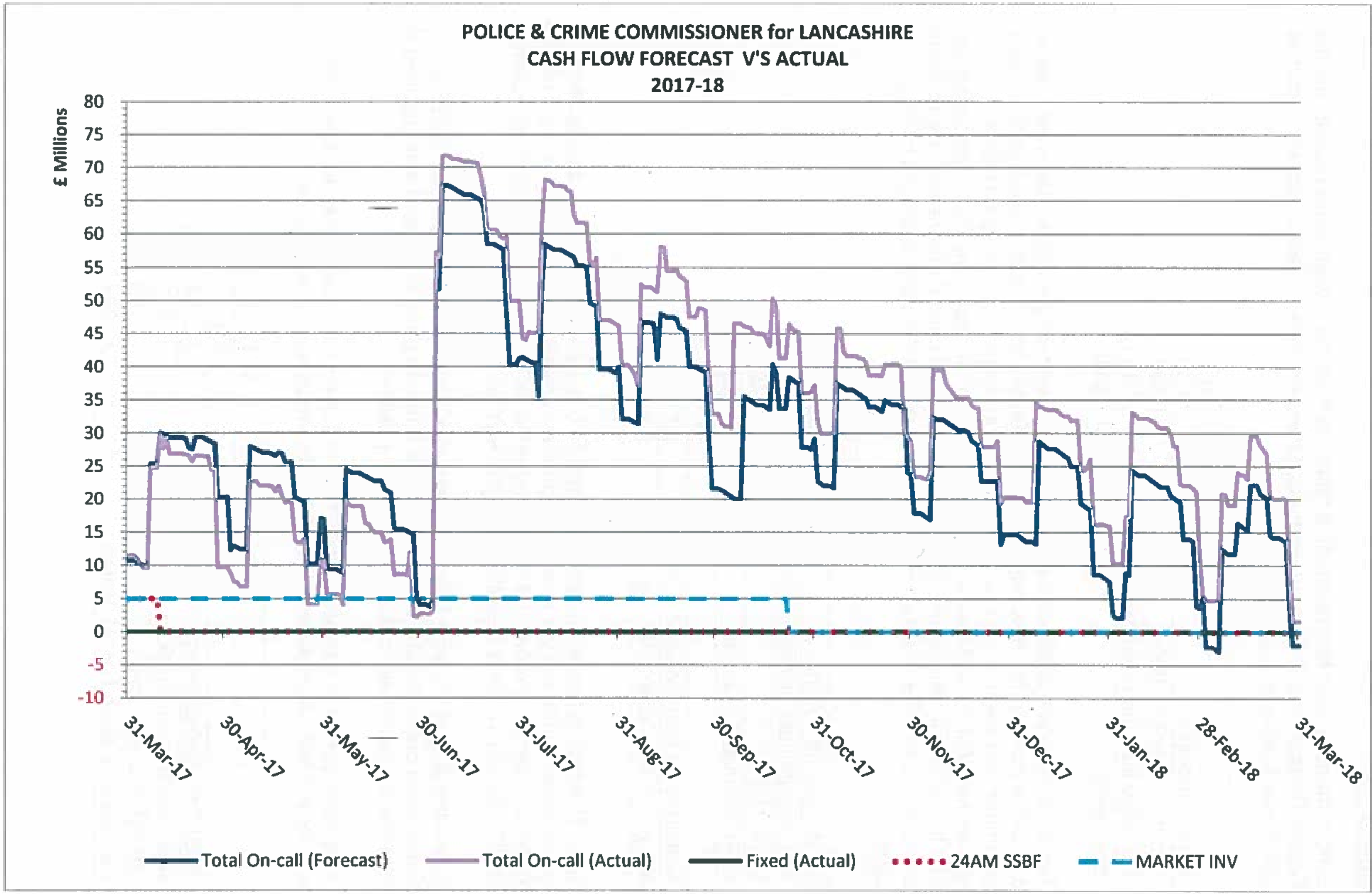
Short term interest rates continue to be at historically very low levels. As referred to above 2017/18 saw the first increase in interest rates for a decade when in November the base rate was increased to 0.5% from 0.25%. The expectation during the year was that interest rates would remain low for the rest of the financial year and beyond. It is anticipated that although rates may increase they will remain at low levels. Lancashire County Council's Treasury Management advisors, Arlingclose Treasury Consultants, are forecasting two small increases in 2018/19 with base rates being at 1% in March 2019.

Cash Flow.

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

The graph below shows the forecasted and actual cash flows over the last 12 months. Broadly speaking it can be seen that the cash flow projections are reasonably accurate. The cash flow position, along with the interest rate environment, form part of the regular discussions between the Chief Finance Officer and the Lancashire County Council Treasury Management Team, in order to inform future decisions on borrowing and investments.

Appendix A


POLICE & CRIME COMMISSIONER for LANCASHIRE
CASH FLOW FORECAST V'S ACTUAL
2017-18
£ Millions
80
75
70
65
60
55
50
45
40
35
30
25
20
15
10
5
0
-5
-10
31-Mar-17
30-Apr-17
31-May-17
30-Jun-17
31-Jul-17
31-Aug-17
30-Sep-17
31-Oct-17
30-Nov-17
31-Dec-17
31-Jan-18
28-Feb-18
31-Mar-18
Total On-call (Forecast)
Total On-call (Actual)
Fixed (Actual)
24AM SSBF
MARKET INV

Borrowing

Long term borrowing has been, or is taken, to fund the investment in assets via the Capital Programme. During the year capital expenditure of £29.515m was incurred which was funded as follows:

	£m
Capital receipts	0.630
Grant and contributions	1.832
Revenue including reserves	9.049
Borrowing	18.004

The level of capital expenditure financed from borrowing is higher than most years due to the work on the new police station at Blackpool. This has an impact on both the underlying need to borrow for capital, as indicated by the capital finance requirement (CFR), but also on the cash flows in the year. The PCC has continued with the policy of utilising the cash balances to fund capital programme expenditure. Comparing the CFR to actual debt illustrates the use of cash balances to fund capital.

	£m
CFR Balance 1 April	40.223
Add expenditure financed from borrowing	18.004
Less: MRP	-0.402
CFR Balance 31 March	57.825
Outstanding borrowing 31.3.18	22.054
Financed from cash balances	35.771

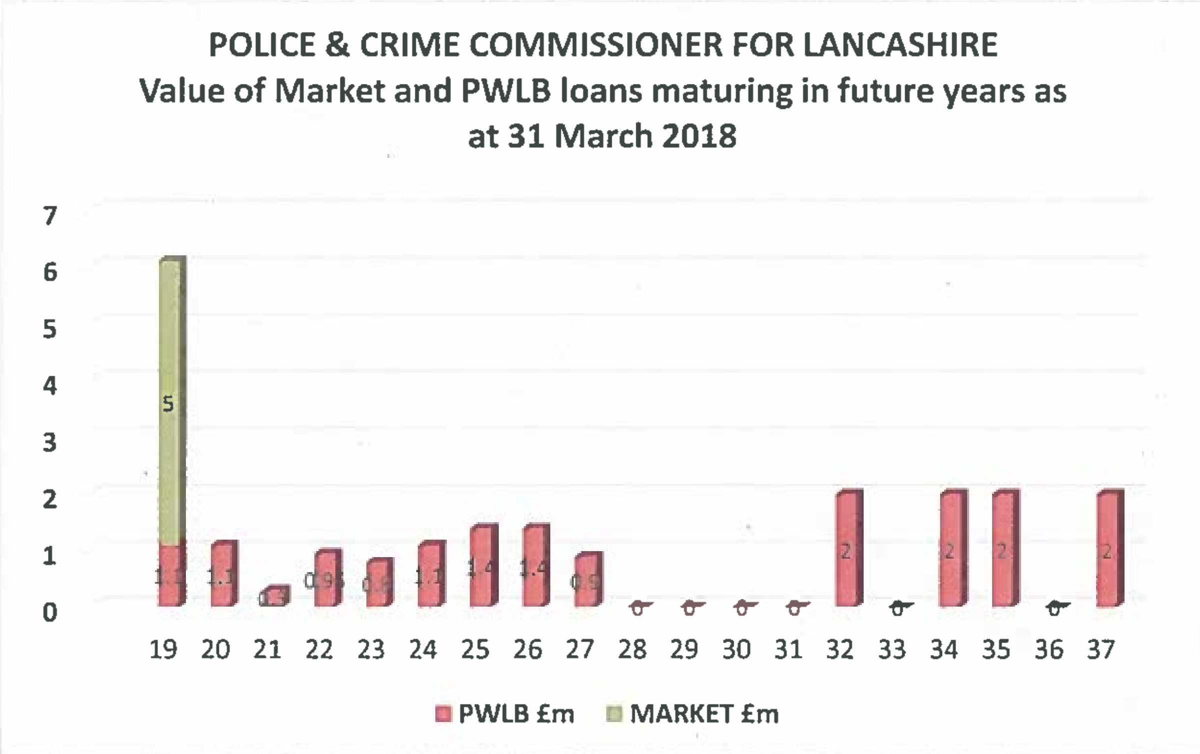
Note: The capital financing requirement (CFR) is a measure of the accumulated capital expenditure not yet financed either by capital resources or the annual charge made to revenue to repay the debt; referred to as the minimum revenue provision (MRP). During the year the MRP charged was £0.402m.

New borrowing in the year has been kept to a minimum with a new loan of £5m being taken out in March. This loan is for a 6 month period only and was required to help ensure cash balances held remained positive.

Long term loans are held with the PWLB and during the year a loan matured which was repaid and not replaced. The borrowing position is shown below:

	2017/18
	£m
Total Debt Outstanding 1st April	18.154
Add New borrowing taken	5.000
Less Borrowing repaid	-1.100
Borrowing outstanding 31 March	22.054

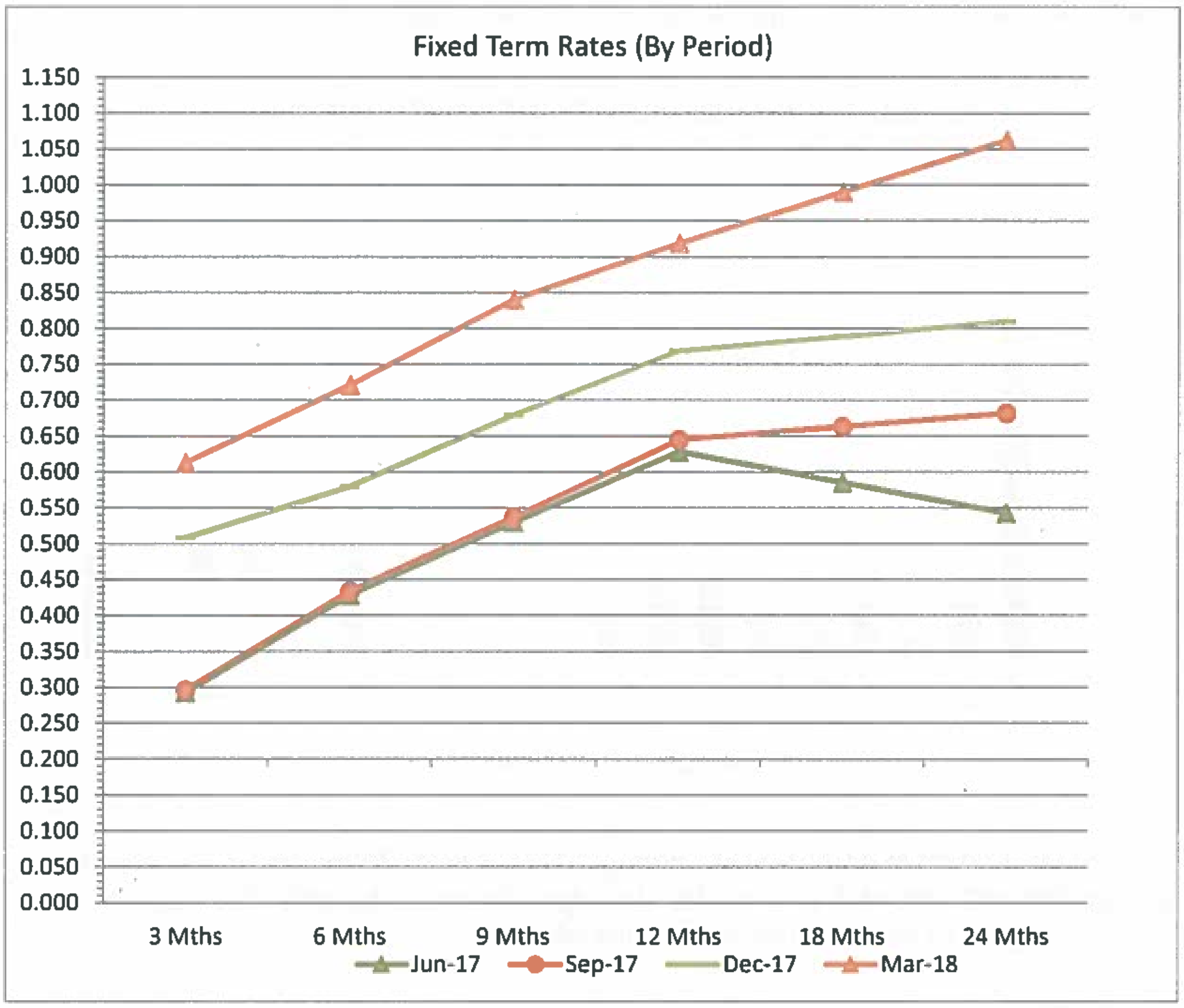
The charts below show the current maturity profile of the borrowings.



Total interest payable on borrowing during 2017/18 is £0.783m, which equates to an average interest rate of 4.38% on the average debt outstanding for the year. A further £0.013m of interest was paid on transferred debt.

Investments

Both the CIPFA Code and the DCLG 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. However, interest rates continued to be low in 2017/18 and the chart below gives an indication of the rates available in the year. However, they might have been offered by lenders who do not meet the credit rating criteria of the PCC's policy.



As referred to earlier in the report the cash-flow policy has been to minimise the borrowing which reduces the resources available for investment. Therefore, a call account is an appropriate arrangement for the PCC. In order to reduce credit risk to the PCC, Lancashire County Council (credit rating by Moodys AA2) is the main counterparty for the PCCs investments via the operation of a call account. Although the Treasury Management Strategy does include other high quality counterparties and a £5m three year fixed term investment matured in the year.

The call account provided by Lancashire County Council paid the base rate throughout 2017/18. Each working day the balance on the Authority'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 £32.117m earning interest of £0.108m.

The overall interest earned during this period was £0.150m at a rate of 0.43% which compares favourably with the benchmark 7 day notice index which averages 0.35% over the same period.

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

Cash flow and interest rates continue to be monitored by the Chief Finance Officer and the County Council's treasury management team, and when rates are felt to be at appropriate levels further term deposits will be placed.

Prudential Indicators

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 2017/18 are shown in the table below alongside the actual outturn position.

	2017-18 PIs	**Actual**
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	43,000	22,054
Other long-term liabilities	1,000	0
Total	44,000	22,054
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	40,000	22,054
Other long-term liabilities	500	0
Total	40,500	22,054
Upper limit for fixed interest rate exposure		
Borrowing	100%	100%
Investments	100%	0%
Upper limit for variable rate exposure		
Borrowing	75%	0%
Investments	100%	100%
Upper limit for total principal sums invested for over 364 days (per maturity date)	50%	0%
Maturity structure of debt	**Upper/ Lower Limits**	**Actual**
Under 12 months	70% / nil	28%
12 months and within 24 months	60% / nil	5%
24 months and within 5 years	65% / nil	9%
5 years and within 10 years	80% / nil	22%
10 years and above	90%/10%	36%

Financial Implications

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

	Budget £m	Actual £m	Reason for variance
Interest Payable on PWLB loans and transferred debt	1.354	0.799	Level of borrowing required for the capital programme lower than anticipated as a result of the significant re-phasing of the accommodation element of the programme in recent years
Interest Receivable on call and fixed term investments	(0.429)	(0.207)	Lower income due to reduction in cash balances held during the year
Minimum Revenue Provision	1.326	0.402	MRP lower due to review of policy and slippage on capital programme
Net financing costs from Treasury Management activities	2.251	0.994	

Human Resource Implications

None

Equality and Diversity Implications

None

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 an assurance that this has been complied with.

Environmental Impact

None

Background Papers

I. CIPFA – Treasury Management Code of Practice – 2011 Edition
II. Treasury Management Strategy 2017/18

Contact Officer

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