REPORT TO: **JOINT MANAGEMENT BOARD**

DATE: **24 AUGUST 2017**

AGENDA ITEM: 2

SUBJECT: 2016/17 TREASURY MANAGEMENT YEAR END POSITION

Executive Summary

This report sets out the Commissioner's borrowing and lending activities during 2016/17. All borrowing and investment activities undertaken throughout the year are in accordance with the 2016/17 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 Police and Crime Commissioner Date: 24 August 2017	Signature Chief Constable Date: 24 August 2017

2016/17 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 on performance. This report sets out the Commissioner's borrowing and lending activities during 2016/17.

Economic Background

Treasury Management activity is influenced by the actual and forecast economic position. The economic situation in the year was largely dominated by the uncertainty about the short and medium term implications of the decision in June 2016 to leave the European Union. In response to the risk of reduced economic growth the Bank of England Monetary Policy Committee initiated substantial monetary policy easing at its August meeting. This included a cut in Bank Rate to 0.25%, further gilt and corporate bond purchases (QE) and cheap funding for banks (Term Funding Scheme) to maintain the supply of credit to the economy.

The year has seen steady economic growth although the final quarter is at a lower rate with the quarterly rates being:

Quarter ended :	GDP growth (%)
June 2016	0.6
September 2016	0.5
December 2016	0.7
March 2017 (provisional)	0.2

Inflation remained low in the first half of 2016 but there has been signs of this increasing towards the end of the year with inflation as measured by RPIH being at 2.3% at March 2017. However, since the referendum vote the value of sterling has fallen and this is a significant factor behind the increase in inflation. The unemployment rate dropped to 4.7% in February its lowest level in 11 years.

However, the year has seen significant volatility in the financial markets as a result of both the UK vote to leave the European Union and Donald Trump being elected as President of the USA. As a consequence of the uncertainty Gilt yields fell, Fitch and Standard & Poor's downgraded the UK's sovereign rating to AA and the value of sterling fell. The impact of the negotiations to leave the European Union will be a source of on-going volatility.

Interest Rate Environment

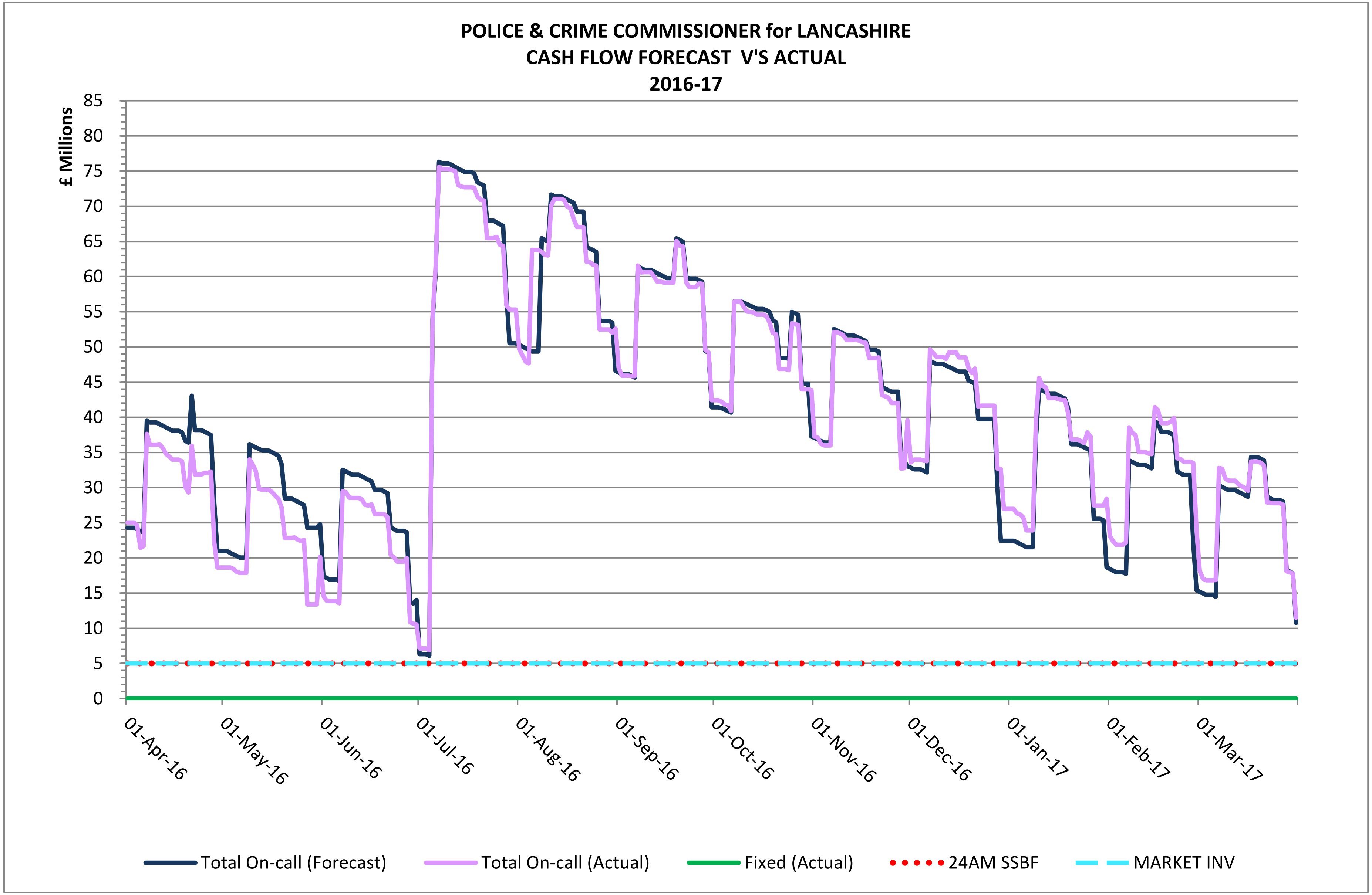
Short term interest rates continue to be at historically very low levels. As referred to above in response to a potential reduction in economic growth the Bank of England reduced the base rate from 0.5% to 0.25% in August 2016; a level it remained at throughout the rest of the year. The expectation during the year was that interest rates would remain low for the rest of the financial year and beyond. This is still the case with Lancashire County Council's Treasury Management advisors, Arlingclose Treasury Consultants, not forecasting an increase up to June 2020.

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
2016-17
£ Millions
85
80
75
70
65
60
55
50
45
40
35
30
25
20
15
10
5
0
01-Apr-16
01-May-16
01-Jun-16
01-Jul-16
01-Aug-16
01-Sep-16
01-Oct-16
01-Nov-16
01-Dec-16
01-Jan-17
01-Feb-17
01-Mar-17
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 £22.597m was incurred which was funded as follows:

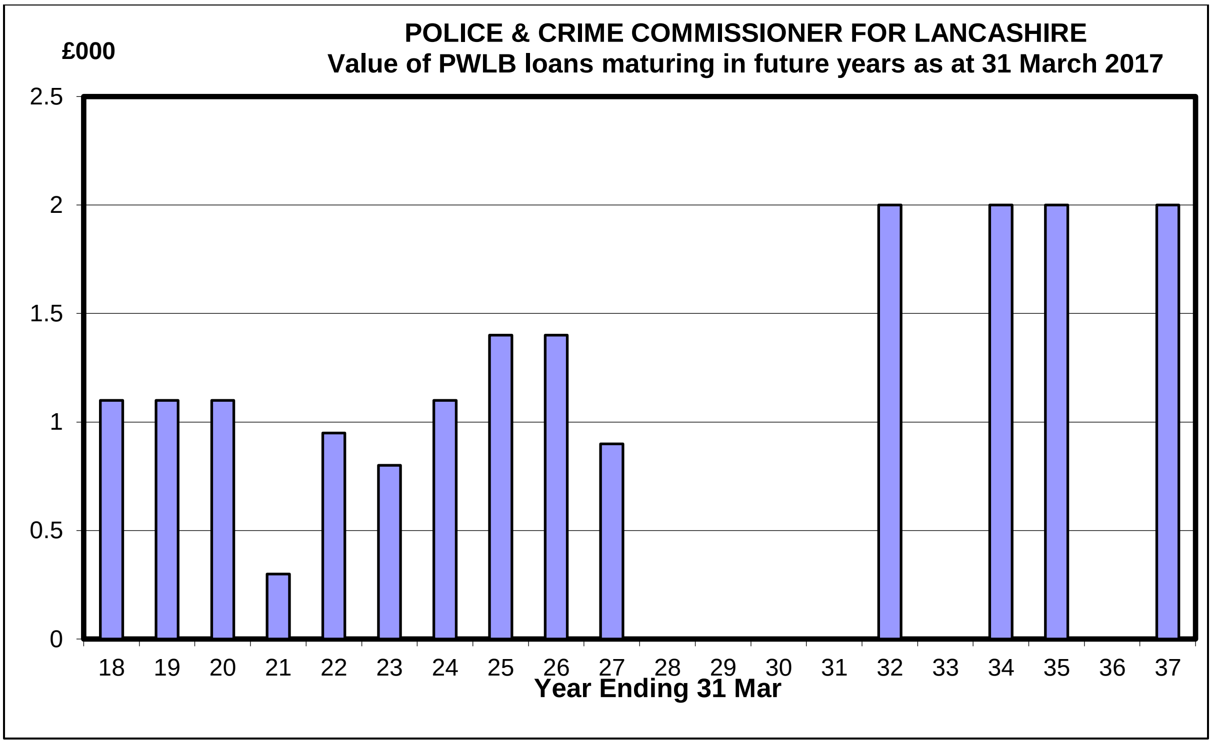
	£m
Capital receipts	8.585
Grant and contributions	1.641
Revenue including reserves	7.074
Borrowing	5.297

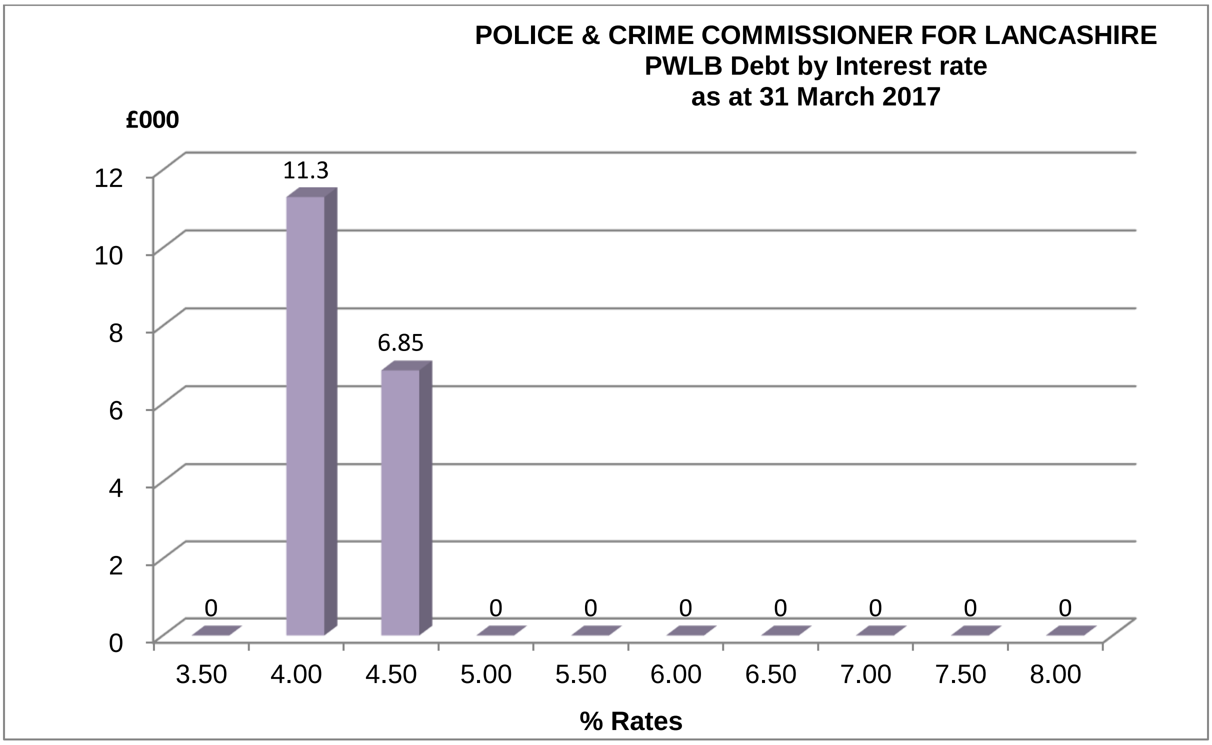
However, the PCC's cash investments remain significantly in excess of borrowing requirements. To avoid excess borrowing the policy of utilising these cash balances to fund capital programme expenditure has been continued and no new borrowing has been taken out in the year.

In addition a loan matured in 2016/17 which was repaid and not replaced. The borrowing position is as shown below:

	2016/17
	£m
Total Debt Outstanding 1st April	18.654
Add New borrowing taken	0
Less Borrowing repaid	-0.500
Borrowing outstanding 31 March	18.154

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





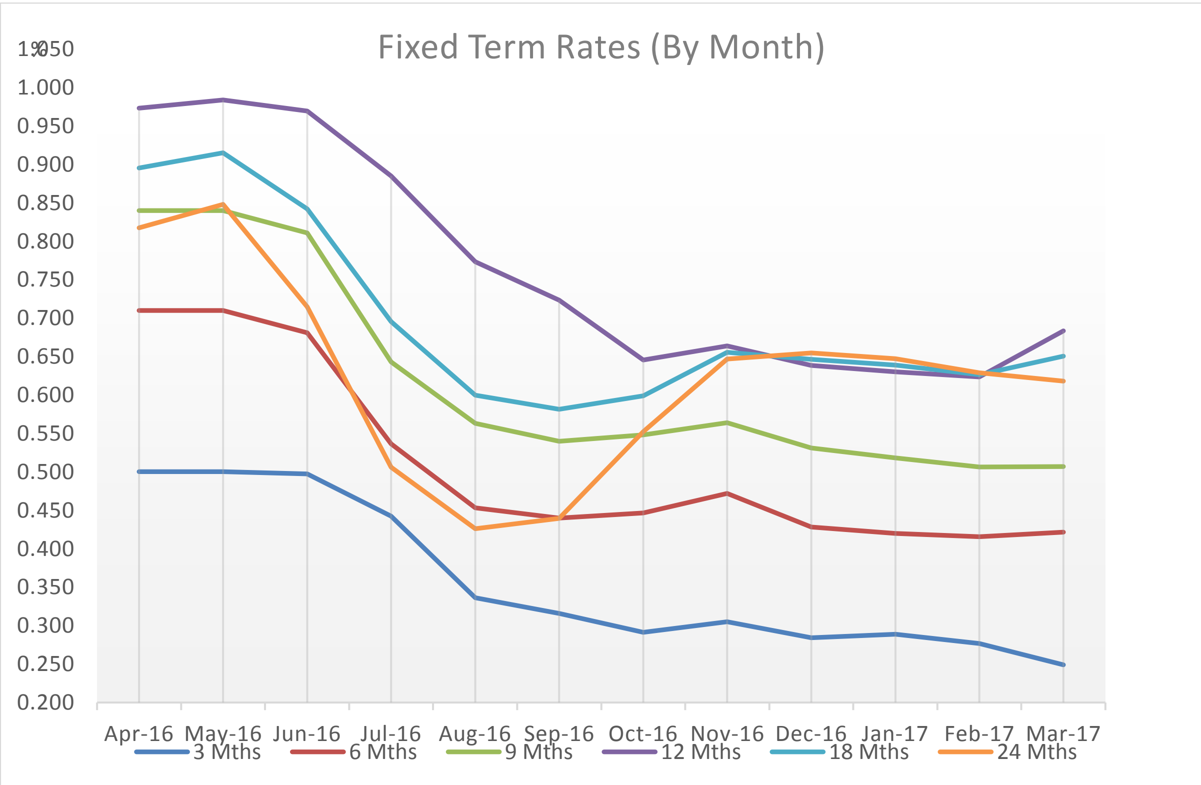
Total interest payable on borrowing during 2016/17 is £0.824m, which equates to an average interest rate of 4.44% on debt outstanding at 31.3.17.

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 £1.255m. Comparing the CFR to actual debt illustrates the use of cash balances to fund capital.

	£m
Balance 1 April	36.179
Add expenditure financed from borrowing	5.297
Less: MRP	-1.255
Balance 31 March	40.221
Outstanding borrowing	18.154
Financed from cash balances	22.067

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 2016/17 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.



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. However the Treasury Management Strategy does include other high quality counterparties. In accordance with this policy, one long term investments is held with a UK local authority as outlined below:

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

The call account provided by Lancashire County Council paid the base rate throughout 2016/17. 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 £40.271m earning interest of £0.130m.

The overall interest earned during this period was £0.205m at a rate of 0.45% which compares favourably with the benchmark 7 day notice index which averages 0.36% 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 2016/17 are shown in the table below alongside the actual outturn position.

	2016-17 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	26,000	18,154
Other long-term liabilities	1,000	0
Total	27,000	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 PCC's current plans		
Borrowing	23,000	18,154
Other long-term liabilities	500	0
Total	23,500	18,154
	2016-17 PIs	**Actual**
Upper limit for fixed interest rate exposure		
Borrowing	100%	100%
Investments	100%	30%
Upper limit for variable rate exposure		
Borrowing	75%	0%
Investments	100%	70%
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	50% / nil	0%
12 months and within 24 months	50% / nil	0%
24 months and within 5 years	50% / nil	12%
5 years and within 10 years	80% / nil	23%
10 years and above	90% / 25%	65%

Financial Implications

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

	Budget	**Actual**	**Reason for variance**
	£m	£m	
Interest Payable on PWLB loans and transferred debt	2.343	0.836	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)	(0.205)	Lower income due to reduction in interest rates during the year
Minimum Revenue Provision	1.326	1.255	MRP lower due to slippage on capital programme in 2015/16

Net financing costs from Treasury Management activities	3.240	1.886	

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 members with 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 2016/17

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