DECISION: 2020/08	**DATE: 29 JUNE 2020**
TITLE: 2019/20 TREASURY MANAGEMENT YEAR-END POSITION	
REPORT BY: STEVE FREEMAN	
Executive Summary This report sets out the Commissioner's borrowing and lending activities during 2019/20. All borrowing and investment activities undertaken throughout the year are in accordance with the 2019/20 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 Treasury Management year-end position report for 2019/20.	
Signature Clive Grunshaw Police and Crime Commissioner Date 1 July 2020	

1. Background and Advice

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. Investment and borrowing decisions are taken in the light of long term borrowing requirements, the estimated level of reserves and actual and estimated cash-flow. Consideration is also given to various risks and ensuring compliance with the Prudential Indicators. Decisions are taken in the light of current and forecasted economic information. Therefore this report provides information on:

- An economic overview for the year
- Borrowing activity during the year
- Investment activity during the year
- Comparison to the Prudential

Economic Background

The UK's exit from the European Union and future trading arrangements, had remained one of major influences on the UK economy and sentiment during 2019/20. The 29th March 2019 Brexit deadline was extended to 12th April, then to 31st October and finally to 31st January 2020. The UK's negotiations on the exit from the European Union together with its future trading arrangements drove volatility, The outcome of December's General Election removed a lot of the uncertainty and looked set to provide a 'bounce' to confidence and activity.

The headline rate of UK Consumer Price Inflation UK Consumer Price Inflation fell to 1.7% in February, below the Bank of England's target of 2%. Labour market data remained positive. The ILO unemployment rate was 3.9% in the three months to January 2020 while the employment rate hit a record high of 76.5%. The average annual growth rate for pay excluding bonuses was 3.1% in January 2020 and the same when bonuses were included, providing some evidence that a shortage of labour had been supporting wages.

GDP growth in Q4 2019 was reported as flat by the Office for National Statistics and service sector growth slowed and production and construction activity contracted on the back of what at the time were concerns over the impact of global trade tensions on economic activity. The annual rate of GDP growth remained below-trend at 1.1%.

However, coronavirus changed everything. COVID-19, spread across the globe in early 2020 causing falls in financial markets not seen since the Global Financial Crisis

In response to the spread of the virus and sharp increase in those infected, the government enforced lockdowns, central banks and governments around the world cut interest rates and introduced massive stimulus packages in an attempt to reduce some of the negative economic impact to domestic and global growth.

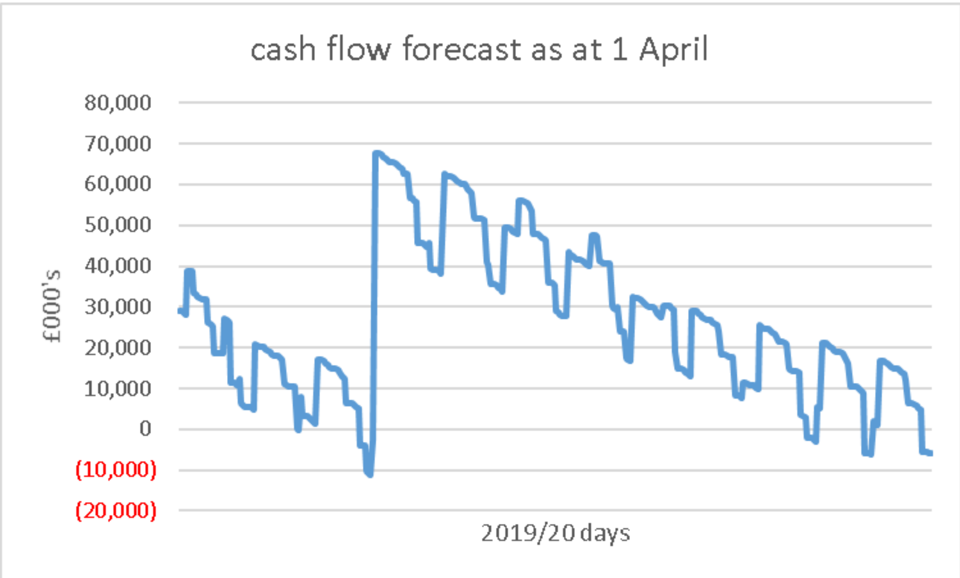
The Bank of England, which had held policy rates steady at 0.75% through most of 2019/20, moved in March to cut rates to 0.25% and then swiftly thereafter brought them down further to the record low of 0.1%. In conjunction with these cuts, the UK government introduced a number of measures to help businesses and households impacted by a series of ever-tightening social restrictions, culminating in pretty much the entire lockdown of the UK.

The US economy grew at an annualised rate of 2.1% in Q4 2019. After escalating trade wars and a protracted standoff, the signing of Phase 1 of the trade agreement between the US and China in January was initially positive for both economies, but COVID-19 severely impacted sentiment and production in both countries. Against a slowing economic outlook, the US Federal Reserve began cutting rates in August. Following a series of five cuts, the largest of which were in March 2020, the Fed Funds rate fell from of 2.5% to range of 0% - 0.25%. The US government also unleashed a raft of COVID-19 related measures and support for its economy including a $2 trillion fiscal stimulus package. With interest rates already on (or below) the floor, the European Central Bank held its base rate at 0% and deposit rate at -0.5%.

With the crisis there has been flight to quality in financial markets resulting in gilts yields to fall substantially for example the 10-year benchmark yield fell from 1% to 0.4%,

Cash Flow

The graph below shows the forecasted balances held for the 12 months as estimated at 1 April if no further borrowing or investments were taken. This shows a picture of times when balances were low or even negative and this was the focus of the treasury management in the year. The cash flow forecasts are updated daily and 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.



Borrowing

Long term borrowing has been, or is taken, to fund the investment in assets which has been incurred via the Capital Programme. The overall need to borrow for capital purposes is shown by the capital financing requirement (CFR)

In considering the borrowing undertaken by the PCC consideration was given in relation to:

- The need to borrow as indicated by the CFR and cash-flow forecasts
- The cost of borrowing both in the immediate year and future years

- Risk of liquidity, in other words will the cash be available when required

The PCC has in recent years undertaken a policy of utilising the cash balances to fund capital programme expenditure and some of the borrowing that was taken has been of short duration. Therefore it was reported in the 2019/20 Treasury Management Strategy it was anticipated that there would be a need to borrow for 2019/20 of up to £38m. During the year capital expenditure of £12.625m was funded as follows:

	£m
Capital receipts	0.000
Grant and contributions	1.920
Revenue including reserves	9.124
Borrowing	1.581

The use of borrowing to finance capital expenditure in year was less than anticipated at the beginning of the year.

It was against the background of long term borrowing need and cash flow projections showing low balances that decisions on borrowing were made. Using short term borrowing is a cost effective option in the year, as short term rates are usually cheaper than long term. This however may not be the case in the longer term as the necessary replacement loans may be cost more as interest rates rise or liquidity becomes scarcer. Therefore, the Chief Finance Officer in consultation with LCC's treasury management team has constantly reviewed the long term PWLB rates with a view to taking some long term borrowing to finance the capital programme

Consequently, during the year there has been a mixture of long and short term borrowing held. The long term loans have been with the PWLB while short term loans have been taken with other local authorities. In addition in March 2020 a one year loan of £17.5m was taken with the PWLB. This was taken to mitigate against possible liquidity issues in 2020/21 arising from the COVID-19 crisis as the PCC still has a borrowing requirement in 2020/21.

PWLB rates are at historically low levels but they do change twice daily. They are monitored to try and ensure best value but the overriding reason for borrowing is need. Given the capital need and cash flow position, the following loans were taken:

Amount £m	Period (years)	Interest Rate (%)
1.500	10	1.55
1.500	34.5	1.75
15.000	1	1.82

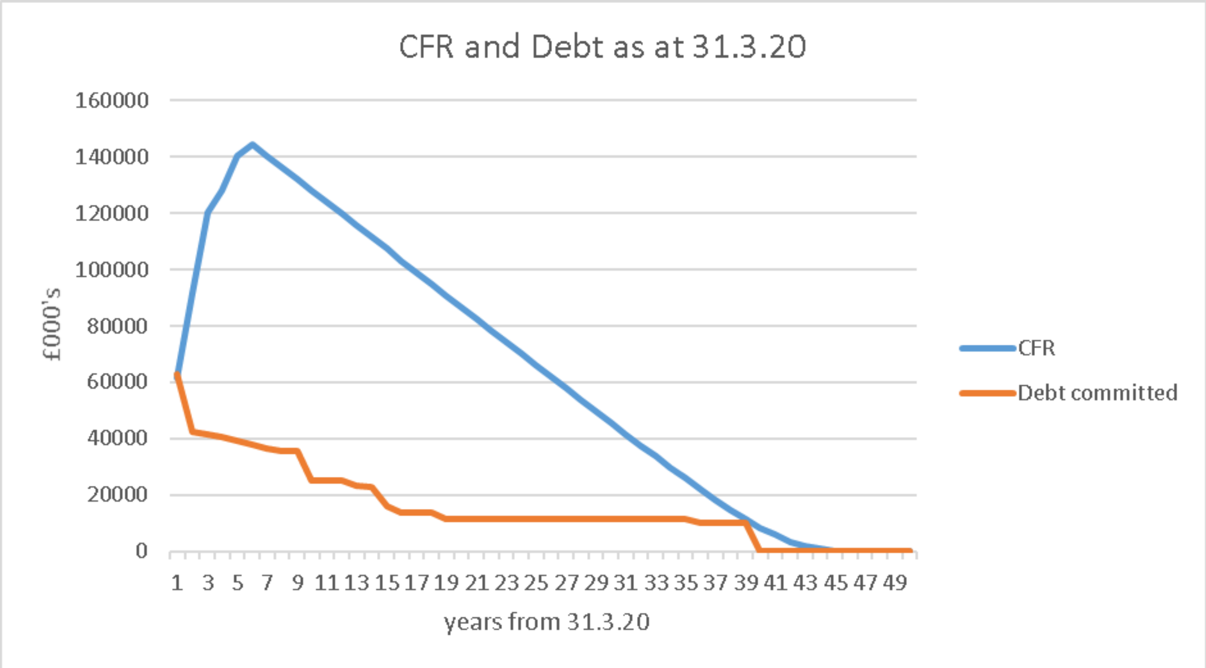
Other loans were taken with other local authorities on a short term. The table below shows the movement in the borrowing in 2019/20:

	PWLB	Other	Total
	£m	£m	£m
Outstanding 1st April	40.954	26.000	66.954
Add New borrowing taken	18.000	5.000	23.000

Less Borrowing repaid	-1.100	-26.000	-27.100
Borrowing outstanding 31 March	57.854	5.000	62.854

The table and graph below show that although the CFR was fully funded at 31.3.20 this was partly the result of the short term borrowing. The table below illustrates that the long term debt only accounts for less than 50 % of the estimated borrowing requirement at 31.3.21 while the graph demonstrates that the PCC still has a long term need to borrow to fund its expenditure on assets. Long term rates will continue to be monitored and further loans may be taken; however the cost in year of any new loan compared to using available cash will be taken into account.

	Actual	**Estimated**
	2019/20	**2020/21**
CFR Balance 1 April	61.288	61.773
Add expenditure financed from borrowing	1.581	31.201
Less: MRP	-1.096	-1.135
CFR Balance 31 March	61.773	91.839
Outstanding borrowing 31. March	62.854	42.479
Financed from cash balances/borrowing requirement	0	49.360



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 £1.096m.

As a consequence of existing debt and decisions taken on new debt then total interest payable on borrowing during 2019/20 was £1.328m, which equates to an average interest rate of 2.57%% on the average debt outstanding for the year.

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 2019/20 with the Bank of England base rate being 0.75% at the beginning of the financial year but falling to 0.1% by the end of the year.

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 Aa3) is the main counterparty for the PCCs investments via the operation of a call account. The Treasury Management Strategy does include other high quality counterparties and one short term fixed investment was undertaken when balances were high.

The call account provided by Lancashire County Council paid the base rate throughout 2019/20. 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 £36.932m earning interest of £0.268m.Including the fixed term deposit interest earned during the year was £0.281m at an average rate of 0.73%, which broadly compares to the Sterling Overnight rate 7 day rate index which averages 0.74% 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 cash flow permits and 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 2019/20 are shown in the table below alongside the actual outturn position.

	2019-20 revised PIs	**Actual**
Adoption of the CIPFA Code of Practice for Treasury Management	Adopted	Adopted
Authorised limit for external debt	£m	£m
A prudent estimate of total external debt, which t allows sufficient headroom for unusual cash movements		
Borrowing	91.000	62.854

Other long-term liabilities	5.000	0
Total	96.000	62.854
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	75.000	62.854
Other long-term liabilities	500	0
Total	75.500	62.854
	2019-20 PIs	**Actual**
Upper limit for fixed interest rate exposure		
Borrowing	100%	100%
Investments	100%	0%
Upper limit for total principal sums invested for over 364 days (per maturity date)	£300m	0
Maturity structure of debt	**Upper/ Lower Limits**	**Actual**
Under 12 months	90% / nil	32%
12 months and within 24 months	80% / nil	2%
24 months and within 5 years	85% / nil	5%
5 years and within 10 years	85% / nil	20%
10 years and above	95% / 5%	41%

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, debt management expenses and transferred debt	1.446	1.328	Level of borrowing and borrowing rates lower than anticipated with
Interest Receivable on call and fixed term investments	(0.257)	(0.281)	Cash balances held in year higher than anticipated
Minimum Revenue Provision	1.110	1.096	MRP lower due to slippage on capital programme
Net financing costs from Treasury Management activities	2.309	2.143	

2. Links to the Police and Crime Plan

Effective management of the revenue budget in conjunction with strong medium term financial planning including for investment in futures years is vital to enable the PCC to deliver the Police and Crime Plan

3. Consultations

None

4. Implications:

a. Legal

None

b. Financial

The financial implications are contained within the report

c. Equality Impact Assessment

None

d. Data Protection Impact Assessment

None

5 Risk Management

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.

6. Background Papers

I. CIPFA – Treasury Management Code of Practice – 2011 Edition
II. Treasury Management Strategy 2019/20

7. Public access to information

Chief Executive Officer (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…………………………...

Contact: Steve Freeman, Chief Finance Officer
Telephone: 01772 535259