STAFFORDSHIRE COMMISSIONER
Police | Fire and Rescue | Crime

Police and Crime Commissioner Staffordshire (PCC)

Ethics, Transparency and Audit Panel (Police)

11 December 2019

TREASURY MANAGEMENT REPORT FOR THE HALF YEAR ENDED 30 SEPTEMBER 2019

Report of the Staffordshire Commissioner

Background

1. In addition to his existing role overseeing Staffordshire Police, the Staffordshire Commissioner became responsible for the governance of the Staffordshire Fire and Rescue Service from August 2018. However, both remain separate organisations, with separate budgets, staff and governance processes.

2. This report will review the treasury management activities for the Staffordshire Police and Crime Commissioner only; a separate report has been completed for the Staffordshire Commissioner Fire and Rescue Authority. Therefore, reference is made only to the **Staffordshire Police and Crime Commissioner ('the Commissioner')** as part of this report.

Summary

3. The Commissioner has adopted the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice (the CIPFA Code), which requires the Commissioner to approve treasury management semi-annual and annual reports.

4. The Commissioner's treasury management strategy for 2019/20 was approved on 28 January 2019. Due to the substantial sums of money borrowed and invested the Commissioner is exposed to financial risks including the loss of invested funds and the revenue impact of changing interest rates. The successful identification, monitoring and control of risk remains central to the Commissioner's treasury management strategy.

5. This report provides a summary of the Commissioner's treasury management activities for the half-year ended 30 September 2019. It considers both borrowing and investment decisions taken so far in the light of the interest rates and economic conditions prevailing at the time.

Recommendations

6. That the treasury management activities for the half-year ended 30 September 2019 are reviewed, and the Prudential Indicators for treasury management shown at **Appendix 2** be noted.

7. That the decision to undertake long term borrowing continues to be delegated to the Director of Finance for the Commissioner and reported retrospectively to the Finance Panel and the Ethics, Transparency and Audit Panel (ETAP), as per the 2019/20 Treasury Management Strategy.

External Context

8. The UK's political and economic environment during the first half of 2019/20 continued to be dominated by the tensions associated with leaving the European Union (EU). Boris Johnson won the Conservative Party leadership contest to become Prime Minister in July 2019 and committed to leaving the EU regardless of whether a deal is reached. However, his extended prorogation of Parliament was deemed unlawful by the Supreme Court whilst Parliament also voted for a bill requiring a Brexit extension, if a deal was not in place by 19th October.

9. Brexit uncertainties impacted the UK economy as it contracted by 0.2% in Q2 2019 with business investment falling by 0.4%; in this period, UK production registered its largest drop since Q4 2012. Although the employment rate remained high at 76.1%, UK Consumer Price Inflation (CPIH) fell to 1.7% in August 2019, weaker than the consensus forecast of 1.9% and below the Bank of England's target of 2%.

10. On an international setting, concerns over a weaker economic environment in the US alongside trade tensions with China prompted fears over a global economic slowdown. The US Federal Reserve responded by cutting rates in September with market expectations for further rate cuts in the financial year. The Eurozone also showed signs of a slowdown as Germany, its largest economy, contracted for the second time in a year. The European Central Bank (ECB) reduced its deposit rate to -0.5% and announced the recommencement of quantitative easing from 1 November 2019.

11. The uncertain economic environment was reflected in financial markets; equities experienced increased volatility and bonds rallied as investors sought greater security. Gilt yields remained volatile during this period with the 10-year gilt falling from 0.83% in June to 0.55% in September. The US yield curve remains inverted with 10-year Treasury yields lower than US 3-month bills; history has shown that a recession can often follow a yield curve inversion.

Borrowing strategy update

12. At 30 September 2019 the Commissioner held £72.8m of long-term loans as part of its strategy for funding previous and current years' capital programmes. The weighted average rate of interest for all long-term loans is shown in following table. The rate has decreased (improved) from 2018/19 as the Commissioner repaid £1m in PWLB loans that matured in August 2019; these loans had originally been taken out at higher rates than the average for the portfolio.

	2018/19	01/04/19 to 30/09/19
Weighted average rate of interest	3.35%	3.33%

13. The Commissioner is due to repay a further £1m in PWLB loans upon maturity in the second half of 2019/20. A graph illustrating the maturity profile of the long-term loan debt is provided at **Appendix 1**.

14. The Treasury Management Strategy for 2019/20 outlined the long-term borrowing strategy for the year; this was as follows:

    ‘to continue with the use of cash as far as is practical, with the ability to raise long-term loans following consultation with the Director of Finance and the Commissioner.’

15. In accordance with this, cash has continued to be used in lieu of borrowing and no new long-term loans were raised in the first half of the financial year.

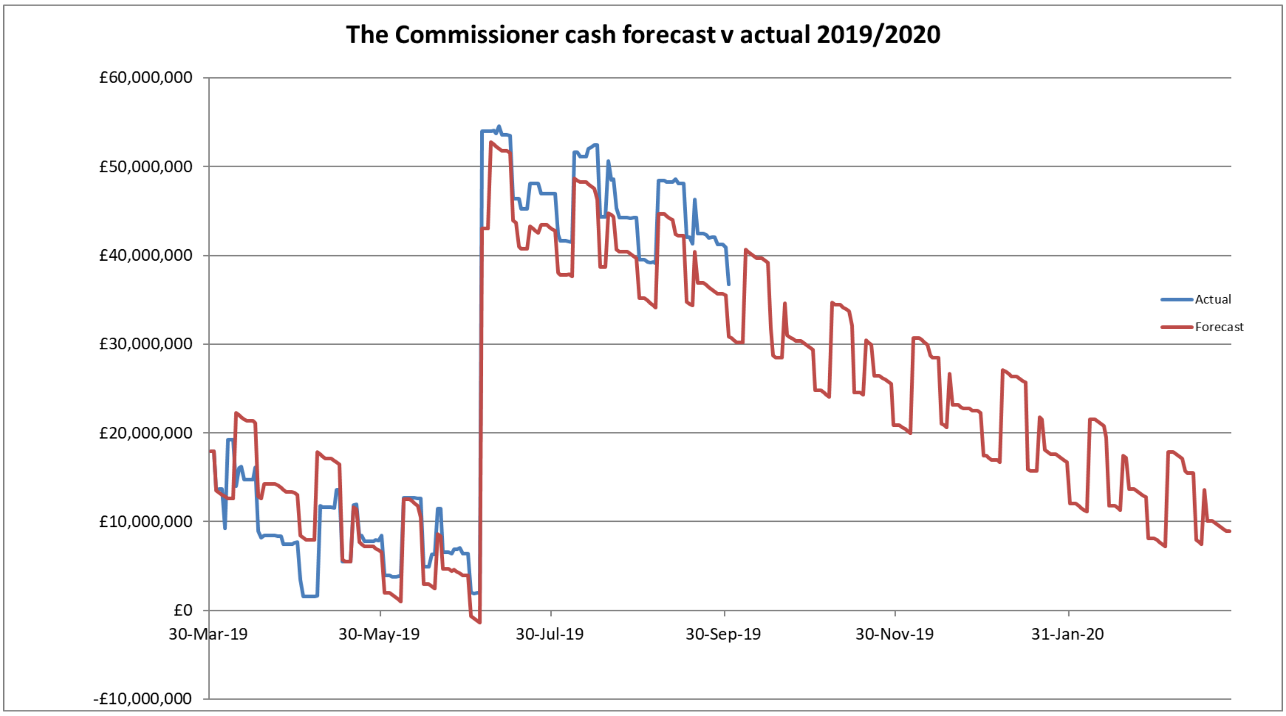
16. The implementation of this strategy has relied on two main factors; the first is the Low Bank Rate set by the Bank of England.

    - The Bank of England maintained Bank Rate at 0.75% and in its August Inflation Report noted the deterioration in global activity and sentiment. The Bank confirmed that monetary policy decisions related to Brexit could be in either direction depending on whether or not a deal is ultimately reached by 31 October 2019.

    - In terms of the future, the County Council provide a Bank Rate forecast, based on advice from their treasury advisor. The Council expect Bank Rate to remain at 0.75% for the foreseeable future although there are significant downside risks to the interest rate forecast, dependent on Brexit and global economic outcomes.

    - Low rates mean that the strategy of using cash is still important, as it represents a cheap way of financing the capital programme. Overall, the short-term interest rate environment now and the forecast continue to support the borrowing strategy adopted in 2019/20.

17. The second element supporting the current strategy is; cash balances being sufficient to meet the Commissioner’s day to day requirements. The following graph shows total actual cash balances for the first half of the year (in blue) against the forecast for the full year (red).



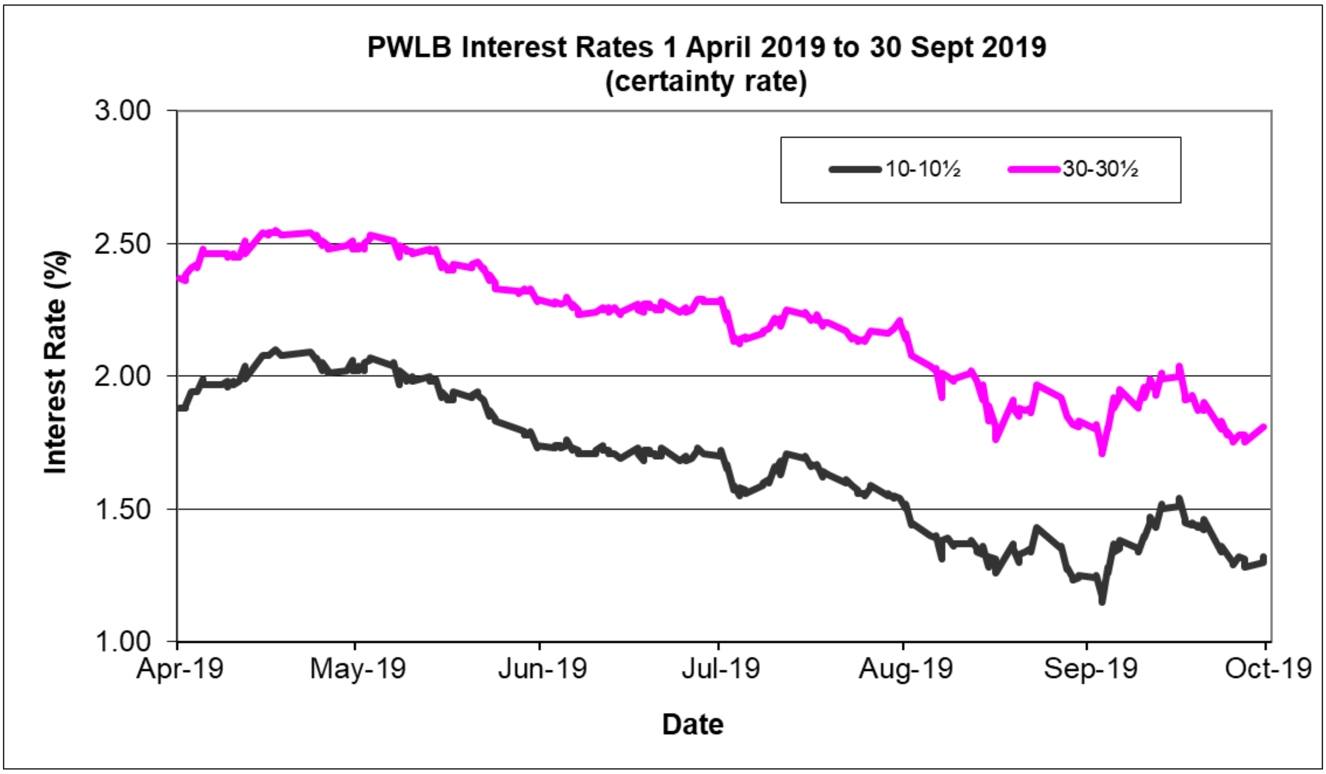
- The graph indicates actual cash balances have by and large followed the forecast at the start of the year.

- Since the beginning of the financial year actual cash balances have been sufficient to allow day to day cash management without the need for short-term loans. Although cash balances came close to nil, the receipt of the pensions grant in July 2019 meant balances returned to a healthy position.

- Cash balances have started to decline from the high in July although forecasts indicate a positive position by the end of the year; cash balances in 2019/20 have been further strengthened by the receipt of additional central government funding for police officers and of capital receipts received earlier than previously anticipated.

18. Forecasts indicate the Commissioner should have sufficient balances to fund its debt for 2019/20. However, its debt is likely to increase in the future due to continued capital expenditure incurred on new IT systems (Niche investment). Therefore, the Commissioner may require long-term borrowing in the near future.

19. The traditional source for long-term borrowing for the Commissioner has been the PWLB (Public Works Loan Board) whose loan interest rates reflect changes in Gilt yields in the UK Government bond market. The following chart shows two typical loan periods where rates have been adjusted to reflect the “certainty-rate” reduction of 0.20% that is available to all local authorities who register with the Government.



20. Gilt yields are very sensitive to the risk appetite of international investors and the current low yields reflect the uncertain global financial environment. Gilt yields decreased throughout the first half of 2019/20 and reached a record low in early September – the 10-year gilt was at 0.382% on 3 September 2019. Investors sought the safety of bond markets in the face of global economic slowdown concerns and a no-deal Brexit and this has been reflected in a similar downturn in PWLB interest rates.

21. On 9 October 2019, HM Treasury, the government department responsible for the PWLB, increased the margin over gilt yields from 80bps to 180bps for certainty rate loans. The government reasoned that the cost of borrowing had fallen to record lows in recent months and some local authorities have substantially increased their use of PWLB borrowing. This new shift in policy was aimed to restore PWLB lending rates to 'normal' levels.

22. The table below compares the certainty rates for standard new maturity 10-year and 30-year PWLB loans under the old and new policy:

PWLB loan period	**Certainty rate 8 Oct 2019 (80 bps above gilt yields)**	**Certainty rate 9 Oct 2019 (180 bps above gilt yields)**
10-10 ½	1.22%	2.25%
30-30 ½	1.76%	2.78%

The new rates are substantially higher than the rates under the old policy although they are still low when compared to historical PWLB rates.

Investment Strategy update

23. The Commissioner holds invested funds, representing income received in advance of expenditure plus balances and reserves held. As shown in the chart at **paragraph 17**, the Commissioner's investment balances during the year have ranged between £1.5m and £54 million due to timing differences between income and expenditure.

24. The Annual Investment Strategy (AIS) forms part of the Treasury Management Strategy and sets out those parties the Commissioner will lend its money to. The AIS details the requirements of government guidance and the CIPFA Code; both documents require the Commissioner to invest its funds prudently and to have regard to the following two prime risk issues over return:
    - The security of capital.
    - The liquidity of investments.

25. The latest AIS is included as part of the Treasury Management Strategy for 2019/20. This identifies that investments can be placed with:
    - Regulation Investments (no financial limit):
        i) UK Government Debt Management Account Deposit Facility (DMADF) (6 months is the maximum period permitted).
        ii) Local Authorities / Parish Councils (12 months).
    - 3 "AAA" rated Money Market Fund's (MMF's) – Up to £1.5m (Instant Access).
    - Lloyds Bank as banking services provider - up to £0.5m (Instant Access).

26. The AIS also states that both the application and amendment of the investments policy are delegated to the Director of Finance at the Commissioner with the outcome reported in the regular treasury management reports.

27. As cash balances at the Commissioner were relatively high from July 2019, the investment limits identified at **paragraph 25** required a greater degree of flexibility - in order to minimise the risk of receiving unsuitably low investment income whilst also maintaining security and liquidity of investments. Returns from the DMADF accounts remained low whilst demand from the local authority lending market dropped as some took advantage of low long-term rates available from the PWLB.

28. As a result, the Commissioner agreed to temporarily increase MMF limits to £4m each and increase the limit for Lloyds Bank balances to £1m. The Commissioner is also in the process of opening an additional MMF account with CCLA Fund managers.

29. The CCLA MMF is deemed a suitable fund for the Commissioner because:

    - It is a UK domiciled fund that may help to reduce some of the Brexit risks of holding wholly foreign domiciled MMFs.
    - It is not restricted to professional investors and is available to retail investors such as the Commissioner.
    - It provides relatively high returns when compared to other available MMFs.
    - Although the fund size is relatively small when compared to other MMFs, the size is more than adequate for the Commissioner's proposed limit of £2m.

30. Approved investments at 30 September 2019 for the Commissioner stood at £40.882m (£20.792m at 30 September 2018). They can be analysed by counterparty, amount, term and credit rating as follows:

Regulation Investments	**£m**	**Term**	**Credit rating**
DMADF	6.200	1 week	Unrated*
Ards & North Down Council	4.000	3 months	Unrated*
Barking & Dagenham Council	5.000	3 months	Unrated*
North Norfolk Council	6.000	1 month	Unrated*
South Somerset Council	2.500	1 month	Unrated*
Southampton Council	5.000	3 months	Unrated*
Banks and building societies			
Lloyds Bank Plc	0.182	Instant Access	A+
Money Market Funds			
State Street	4.000	Instant Access	AAA
Morgan Stanley	4.000	Instant Access	AAA
Aberdeen	4.000	Instant Access	AAA
TOTAL	**40.882**		

**Use of these investments is as set out in Government Regulations*

31. The average return on investments for the half year period compared to the benchmark of 7-day LIBID is shown in the following table.

	2018/19	**01/04/19 to 30/09/19**
Average return on investments	0.59%	0.68%
Average 7-day LIBID *	0.51%	0.53%

** 7 Day LIBID is the average rate of interest at which banks are prepared to lend to each other for up to a week.*

32. The average return on investment was higher than in 2018/19 and the benchmark in 2019/20 so far. This reflects the County Council’s Treasury team managing the Commissioner’s higher cash balances by investing in longer duration investments that carry higher returns e.g. 3-month local authority deposits.

Brexit update

33. The Director of Finance is aware of the risks of a no deal Brexit and the potential delays in redeeming cash balances from non-UK domiciled MMFs. As a result, the Director of Finance will ensure that its account with the DMADF remains available for use in an emergency. The Commissioner will also have its UK-domiciled Lloyds bank account available to hold sufficient liquidity required in the near term and is in the process of opening the UK domiciled CCLA MMF (**see paragraph 28-29)**.

Compliance with Treasury Limits

34. It can be certified that for the half-year ended 30 September 2019:

(i) All transactions were undertaken by authorised officers and within the limits approved by the Commissioner.

(ii) All investments were to counterparties on the approved lending list and fully met the requirements of the relevant legislation.

(iii) The Commissioner operated within the treasury limits and Prudential Indicators set out in County Council Treasury Management Practices and the Treasury Management Strategy for 2019/20. The half-year position against the Prudential Indicators is shown in **Appendix 2**.

David Greensmith
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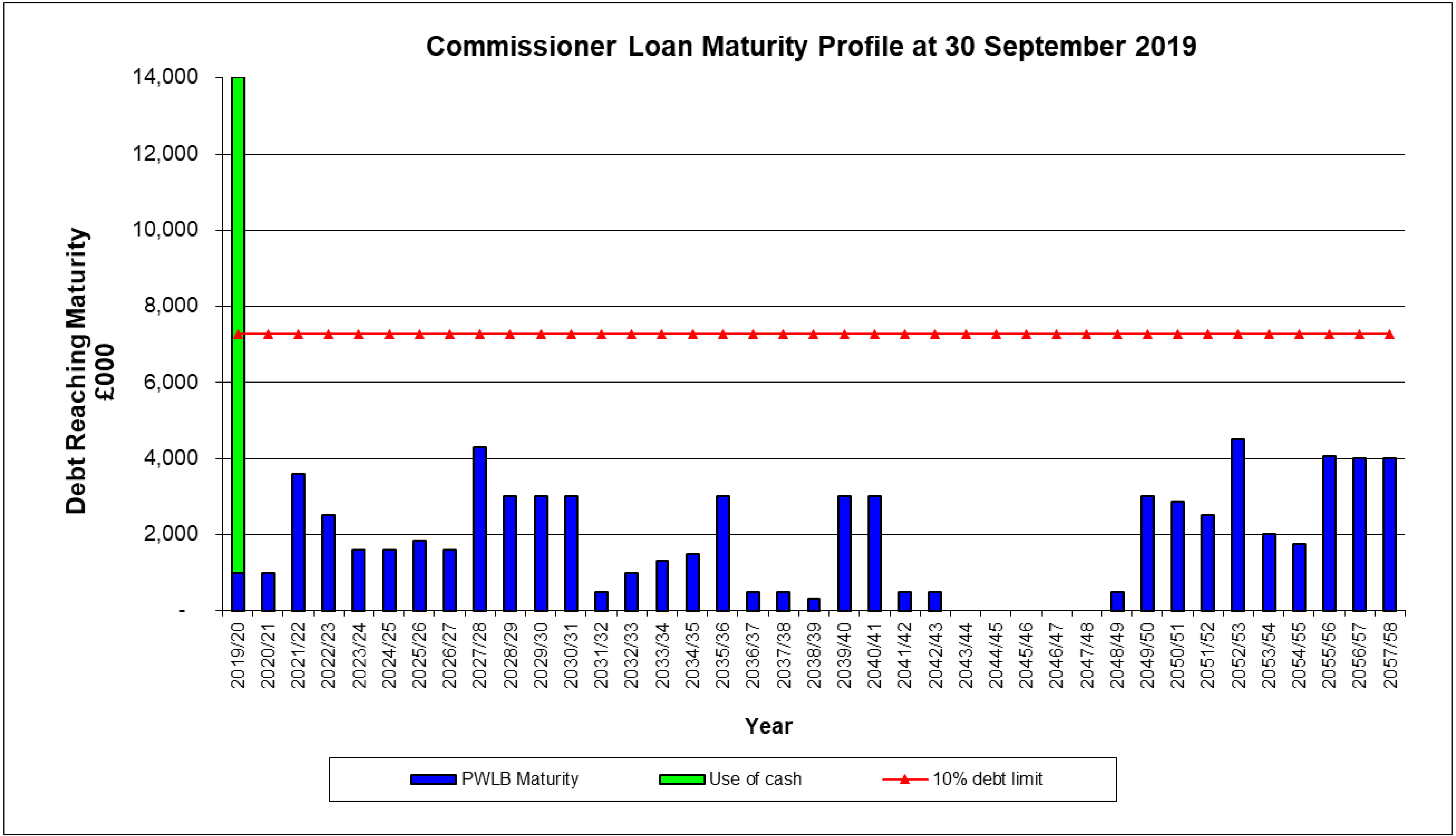
Background Documents

1. Treasury Management in the Public Services: Code of Practice (CIPFA) (2017)
2. Prudential Code for Capital Finance in Local Authorities (CIPFA) (2017)
3. The Local Authorities (Capital Finance and Accounting) (England) Regulations 2003
4. Statutory Guidance on Local Government Investments – Issued under Section 15(1) (a) of the Local Government Act 2003 (2018)



Commissioner Loan Maturity Profile at 30 September 2019
Debt Reaching Maturity £000
14,000
12,000
10,000
8,000
6,000
4,000
2,000
-
2019/20
2020/21
2021/22
2022/23
2023/24
2024/25
2025/26
2026/27
2027/28
2028/29
2029/30
2030/31
2031/32
2032/33
2033/34
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2044/45
2045/46
2046/47
2047/48
2048/49
2049/50
2050/51
2051/52
2052/53
2053/54
2054/55
2055/56
2056/57
2057/58
Year
PWLB Maturity
Use of cash
10% debt limit

Appendix 2

Staffordshire Police and Crime Commissioner

Ethics, Transparency and Audit Panel (Police)
23 October 2019

Prudential Indicators for Treasury Management

Indicator	Estimated 2019/20		Position at 30/09/19
1. External Debt			
a. Authorised Limit	£102.500m		£72.800m
b. Operational Boundary	£92.500m		£72.800m
c. External Loans	£82.025m		£72.800m
The Authorised Limit is the maximum level of external borrowing which should not be exceeded. It is linked to the estimated level of borrowing assumed in the capital programme. *The Operational Boundary represents the Director of Finance's estimate of the day to day limit for treasury management activity based on the most likely i.e. prudent but not worst-case scenario.*			
2. Interest Rate Exposures			
a. Upper Limit (Fixed)	£90.000m		£72.800m
b. Upper Limit (Variable)	(£50.000m)		(£40.882m)
The Commissioner sets upper limits of fixed and variable borrowing and investments. This limits exposure to both fixed and variable interest rate movements as part of the overall risk management strategy for treasury management activities. Negative figures are shown in brackets; these relate to investments at a variable rate which are not offset by variable borrowings.			
3. Maturity Structure of Borrowing	Upper Limit	Lower Limit	
Under 12 months	10%	0%	2.75%
12 months and within 24 months	10%	0%	0.34%
24 months and within 5 years	30%	0%	10.92%
5 years and within 10 years	50%	0%	16.28%
10 years and above	100%	25%	69.71%
This indicator identifies the amount of loans maturing in specified periods. The overarching principle is that steps should be taken from a risk management point of view to limit exposure to significant refinancing risk in any short period of time. *As a result, no more than 10% of fixed rate loans are planned to mature in any one financial year.*			
4. Total principal sums invested for periods longer than a year	nil		nil
Any investments made for longer than a year will be in accordance with the limits on non-specified investments.			