Nottinghamshire

POLICE & CRIME COMMISSIONER

Treasury Management Strategy Statement Mid-year Review Report 2017-18

Incorporating Review of Minimum Revenue Provision Policy and Annual Investment Strategy

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1 Background

The Nottinghamshire Office of the Police and Crime Commissioner (NOPCC) operates a balanced budget, which broadly means income raised during the year (plus planned spending from reserves) will meet its planned expenditure. The treasury management operation ensures the resulting cash flow is adequately planned, with surplus monies being invested in low risk counterparties. It provides adequate liquidity before considering optimising investment return.

The treasury management operation also arranges the funding of capital plans. These capital plans provide a guide to the borrowing need, and form the basis of longer term cash flow planning to ensure that the capital spending operations can be met. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses, and on occasion any debt previously drawn may be restructured to meet risk or cost objectives.

Accordingly, treasury management is defined as: "The management of the local authority's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks." The responsible officer for treasury management is Chief Finance Officer to the Police & Crime Commissioner (Chief Finance Officer).

2 Introduction

The Commissioner complies with the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management.

The primary requirements of the Code are as follows:

- Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of treasury management activities.
- Creation and maintenance of Treasury Management Practices which set out the manner in which to achieve those policies and objectives.
- Reporting requirements

The Commissioner is required to receive and approve, as a minimum, three main reports each year, which incorporate a variety of polices, estimates and actuals.

Treasury Management Strategy Statement - including the Annual Investment Strategy and Minimum Revenue Provision Policy - for the year ahead.

Mid-year Review Report (this report) will update the Commissioner with the position regarding capital, and amend prudential indicators as necessary. It also monitors whether the treasury activity is meeting the strategy and whether any policies require revision. It includes an economic update for the first part of the financial year.

An Annual Report (stewardship report) covering activities during the previous year compared to estimates.

- The responsibility for scrutiny lies with the Commissioner supported by the Audit and Scrutiny Panel. The above reports are reviewed at the Strategic Resources and Performance meetings of the Commissioner.

The codes covering these areas are being revised and early compliance is planned. One of the main items that will require review is that the prudential indicator that links the cost of extra capital to the cost of a Band D council Tax Charge. The reason for this is that the actual impact on a precept increase is influenced by many things and the cost of capital is only one of these. The CFO is considering the alternatives to this now and the views of committee are sought as to what might replace this. There is no standard being suggested and each entity is to decide their own. The existing indicator could still be used if it is considered clear and understandable.

3 Economic update

3.1 Economic performance to date and outlook

3.1.1 U.K.

Following strong growth in 2016, growth in 2017 has been disappointingly weak. Growth in the first half of 2017 was the slowest for the first half of any year since 2012. The main reason for this has been the sharp increase in inflation, caused by the devaluation of sterling after the referendum, which increases the cost of imports. This in turn reduces consumer disposable income. On the positive side there have been encouraging statistics from the manufacturing sector which is seeing strong growth, particularly in exports. However, this sector only accounts for around 11% of GDP.

The Monetary Policy Committee (MPC) meeting of 2 November 2017 increased the bank rate back to 0.5%, the first rise since July 2007. The Bank of England Inflation Reports during 2017 have clearly flagged up that they expected CPI inflation to peak at around 3% in 2017, before falling back to near to its target rate of 2% in two years' time. The focus was on an emerging view that with unemployment falling to only 4.3%, the lowest level since 1975, but with little improvement in productivity that the amount of spare capacity in the economy had reached a trigger point for action. In addition, the MPC took a more tolerant view of low wage inflation as this now looks like a common global factor. This effectively means that the UK labour faces competition from overseas labour which depresses the negotiating power of UK labour

The minutes from the MPC's meeting indicated that the central bank is in "no hurry to raise interest rates again" and that further increases will be limited. There will be careful assessment of the economic situation before further rises takes place.

3.1.2 U.S.A.

Growth in the American economy has been volatile for the last 3 years. For instance in quarter 1 growth was only 1.2%, but quarter 2 rebounding to 3.1%. Unemployment in the US has fallen to the lowest level for many years, reaching 4.4%, while wage and other inflationary pressures have been building. The Fed has started on a gradual upswing in rates with four increases since December 2016, and a further steady incline expected. The Fed has begun to unwind its $4.5 trillion balance sheet holdings of bonds and mortgage backed securities by reducing its reinvestment of maturing holdings at a rate of $10 billion per month. This unwinding of the quantitative easing introduced shortly after the global financial crisis of 2009 is expected to gradually increase to $50 billion per month, as long as the economy continues not to be adversely impacted.

3.1.3 Eurozone

Economic growth in the EU has been lack lustre for several years since the financial crisis, despite the European Central Bank eventually cutting its main rate to -0.4% and embarking on a massive programme of quantative easing. However, growth picked up in 2016 and now looks to have gathered some momentum due to this stimulus. GDP growth was 0.5% in quarter 1 (2.0% y/y) and 0.6% in quarter (2.3% y/y). Despite

this monetary stimulus inflation is 0.5% behind target. It is therefore unlikely to have an upswing in rates until possibly 2019.

3.1.4 China and Japan

Chinese economic growth has been weakening over successive years, despite repeated rounds of central bank stimulus; medium term risks are increasing. Major progress still needs to be made to eliminate excess industrial capacity and the stock of unsold property, and to address the level of non-performing loans in the banking and credit systems.

Japan is struggling to stimulate consistent significant growth and to get inflation up to its target of 2%, despite huge monetary and fiscal stimulus. It is also making little progress on fundamental reform of the economy.

3.2 Interest rate forecasts

The CFO's treasury advisor, Link Asset Services (formerly known as Capita Asset Services), has provided the following forecast.

	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
Bank Rate	0.50%	0.50%	0.50%	0.50%	0.75%	0.75%	0.75%	0.75%	1.00%	1.00%	1.00%	1.25%	1.25%	1.25%
5yr PWLB Rate	1.50%	1.60%	1.60%	1.70%	1.80%	1.80%	1.90%	1.90%	2.00%	2.10%	2.10%	2.20%	2.30%	2.30%
10yr PWLB View	2.10%	2.20%	2.30%	2.40%	2.40%	2.50%	2.60%	2.60%	2.70%	2.70%	2.80%	2.90%	2.90%	3.00%
25yr PWLB View	2.80%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.40%	3.50%	3.50%	3.60%	3.60%
50yr PWLB Rate	2.50%	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.20%	3.30%	3.30%	3.40%	3.40%

The above forecast shows a steady incline in interest rates over the coming years.

Our PWLB rate forecasts are based on the Certainty Rate (minus 20 bps) which is available as long as debt planning information is provided to the Debt Management Office in a timely manner.

The overall balance of risks to economic recovery in the UK remains to the downside, although much depends on the exit deal achieved on the departure from the EU

Downside risks to current forecasts for UK gilt yields and PWLB rates currently include:

- Monetary policy action failing to stimulate significant sustainable growth.
- Weak capitalisation of some European banks.
- A resurgence of the Eurozone sovereign debt crisis.
- Global geopolitical risks increasing safe haven flows.
- Weaker than anticipated UK economic growth and increases in inflation.
- Weak growth or recession in the UK's main trading partners - the EU and US.

The potential for upside risks to current forecasts for UK gilt yields and PWLB rates, especially for longer term PWLB rates include:

- The pace and timing of increases in the USA rate causes a major flight from bonds to equities.
- UK inflation returning to significantly higher levels than in the wider EU and US, causing an increase in the inflation premium inherent to gilt yields.

4 The Commissioner's Office Capital Position (Prudential Indicators)

The Treasury Management Strategy Statement (TMSS) for 2016-17 was approved by the Commissioner on 14 February 2017 (Decision record 2017.006). An update of that information is included here. There are 2 changes required to that information. The first is the incremental impact on band D council tax which unfortunately was reported as £0.35 instead of £3.50. The second is that the CFR will need increasing from £59.775m to £60.987m. Please refer to section 4.2.

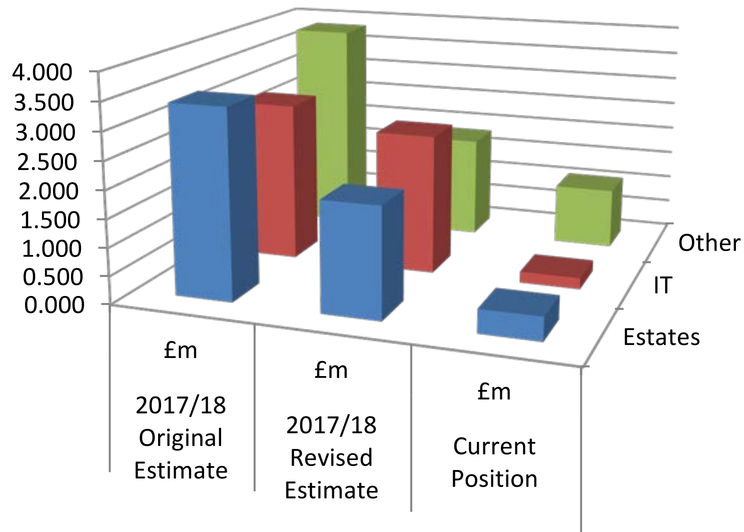
4.1 Prudential Indicator for Capital Expenditure and Financing

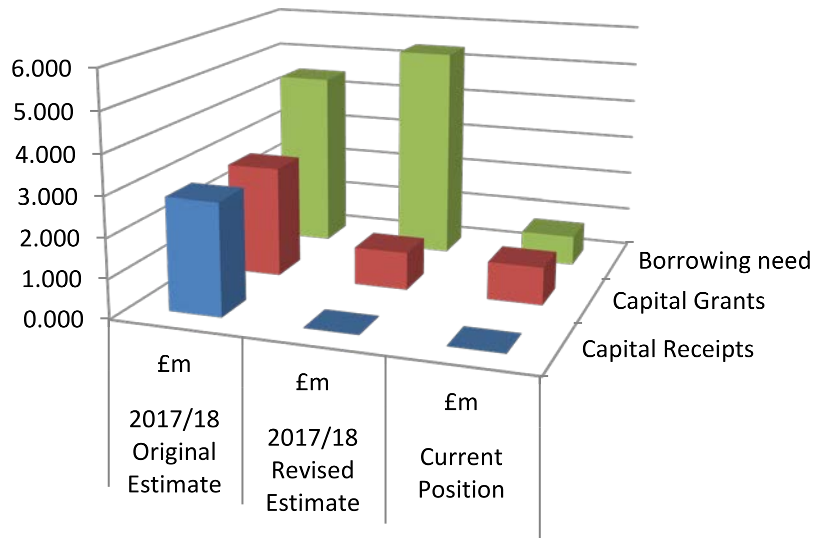
This table shows the revised estimates for capital expenditure and the changes since the capital programme was agreed at the Budget. It also shows the anticipated method of financing.

The borrowing element of the table increases the underlying indebtedness of the Commissioner's Office by way of the Capital Financing Requirement (CFR), although this will be reduced in part by revenue charges for the repayment of debt (the Minimum Revenue Provision). This new borrowing need may also be supplemented by the need to replace maturing debt.

Capital Expenditure 2017/18 by Service

	Original Estimate £m	Original plus Approved Slippage £m	Current Position £m	Revised Estimate £m
Estates	3.393	4.065	0.422	1.970
IT	2.877	5.189	0.200	2.519
Other	3.842	3.927	1.091	1.842
Total	**10.112**	**13.181**	**1.713**	**6.331**
Financed by:				
Capital Receipts	2.828	2.828	0.000	0.000
Capital Grants	2.793	2.793	0.956	0.956
Total Financing	**5.621**	**5.621**	**0.956**	**0.956**
Borrowing need	**4.491**	**7.560**	**0.757**	**5.375**


2017-18 Capital Expenditure
4.000
3.500
3.000
2.500
2.000
1.500
1.000
0.500
0.000
£m
2017/18 Original Estimate
£m
2017/18 Revised Estimate
£m
Current Position
Other
IT
Estates


2017-18 Capital Financing
6.000
5.000
4.000
3.000
2.000
1.000
0.000
£m
2017/18 Original Estimate
£m
2017/18 Revised Estimate
£m
Current Position
Borrowing need
Capital Grants
Capital Receipts

4.2 Prudential Indicator Monitoring

	2016/17 Authority Approved Indicator	2016/17 Outturn @ 31/3/17	2017/18 Authority Approved Indicator	2017/18 Estimate Outturn @ 31/10/17
Section 1 - Indicators Based on Expected Outcomes **Affordability:**				
1) Ratio of Financing Costs to Net Revenue Stream (%)	**2.4**	**1.7**	**2.1**	**1.7**
2) Incremental Impact of Capital Investment Decisions on Band D Council Tax **	**£2.83**	**-**	**£3.50**	**£3.10**
3) Actual Capital Expenditure 31/10/17 (£m)	**-**	**7.132**		**1.712**
Estimated Capital Expenditure 31/10/17 (£m)	**-**	**-**	**10.122**	**6.331**
4) Capital Financing Requirement (£m)	**64.261**	**59.137**	**59.775**	**60.987**
Section 2 - Indicators Based on Limits **Affordability:**				
1) Actual External Debt 31/10/17 (£m)	**-**			**40.878**
Estimated External Debt 31/03/18 (£m)	**-**	**44.303**	**49.064**	**45.153**
2) Authorised Limit for External Debt (£m)	**70.000**	**-**	**70.000**	
3) Operational Boundary for External Debt (£m)	**80.000**	**-**	**80.000**	
Prudence:				
1) Net Borrowing Requirement & CFR (£m)	**64.941**	**58.220**	**64.266**	**66.362**

** The approved indicator 2) was published in error at £0.35 for 2017/18 rather than £3.50

The Capital Financing Requirement is the underlying external need to incur borrowing for a capital purpose. This is calculated on using the best estimate of slippage and capital forecast of project managers at the date of writing (14 November). This is currently within the approved indicator. It also shows the expected debt position over the period, known as the Operational Boundary, the additional amount representing PFI and leasing liabilities and a safety margin.

A key control over treasury activity is a prudential indicator to ensure that over the medium term, net borrowing (borrowings less investments) will only be for capital purposes. Gross external borrowing should not, except in the short term, exceed the total of CFR in the preceding year plus the estimates of any additional CFR for this year and next two financial years. This allows some flexibility for limited early borrowing for future years. The Commissioner has approved a policy for borrowing in advance of need if this proves prudent. The Chief Financial Officer reports that no difficulties are envisaged for the current year but that future capital requirements for significant buildings in the near future require careful consideration and phasing to ensure that this continues to be the case in future years.

A further prudential indicator controls the overall level of borrowing. This is the Authorised Limit which represents the limit beyond which borrowing is prohibited, (The statutory limit determined under section 3 (1) of the Local Government Act 2003). This is approved by the Commissioner and reflects the maximum level of borrowing which, could be afforded in the short term, but is not sustainable in the longer term. It is the expected maximum borrowing need with some headroom for unexpected movements. As with the previous indicator the Chief Financial Officer reports that no difficulties are envisaged for the current year but future years need careful consideration.

5 Investments

In accordance with the Code, the priority is to ensure security of capital and liquidity, and to obtain an appropriate level of return which is consistent with the Commissioner's risk appetite. It will continue to be a very difficult investment market in terms of earning the level of interest commonly seen prior to the financial crisis. Rates are very low in line with the 0.25%/0.5% Bank Rate which has prevailed and are also adversely affected by the new liquidity constraints on financial institutions. The economic situation prompts a low risk and short term strategy.

The Commissioner held £46.8m of investments as at 30 September 2017 (£2.15m at 31 March 2017) and the weighted investment portfolio yield for the first six months of the year is 0.30% against a benchmark (7 day LIBID) of 0.11%

	Position @ 01/04/17 £	Investments made £	Investments withdrawn £	Position @ 30/09/17 £
Temporary Investment				
Banks	0.000	-5.000	0.000	-5.000
Building Societies	0.000	-4.000	0.000	-4.000
Local Authorities	0.000	-17.000	0.000	-17.000
MMF	-2.150	-138.000	119.350	-20.800
Total Investment	**-2.150**	**-164.000**	**119.350**	**-46.800**

Investment:

	Position @ 01/04/17 £m	Investments made £m	Investments withdrawn £m	Position @ 30/09/17 £m
Fixed Term Investment	0.000	-26.000	0.000	-26.000
Variable Term Investment	-2.150	-138.000	119.350	-20.800
	-2.150	**-164.000**	**119.350**	**-46.800**

Proportion of Fixed Term Investment held	55.56%
Proportion of Variable Term Investment held	44.44%

The main investment type employed by the Commissioner is Money Market Funds. (MMF). These are used because they are highly rated (AAA), and they work by spreading the investments over a wide range of high quality counterparties that would be unavailable at the levels of investment monies available. This approach also helps to eliminate risk whilst maintaining liquidity. They also have the advantage of being easy to manage via an online platform and are liquid to meet cash flow demands. Currently 3 are being utilised and at certain times of the year the deposit capacity has been insufficient at a time when alternative institutions of sufficient calibre are reducing or have very low interest rates. There are some counterparties available at reasonable interest rates but they involve fixed term deposits and the cash surplus tends not to be available for a sufficient length of time. Also the interest rate on current account balances with Barclays is minimal.

The current limits in the investment policy for MMFs are for £10m, and £15m with the consent of the CFO. On some occasions the CFO has agreed to temporarily increase this limit. In the first half year when cash surpluses are at their highest there have been there has been 65 days when 1 or more of the 3 funds have been over £10m and up to £15m. There have been 7 days when this has been over £15m, with the consent of the CFO. The maximum value has been £19m in one fund. One option to alleviate this situation would be to open a new MMF, but this is not really widening the portfolio any further, as comparisons of where the MMFs invest show a high degree of overlap.

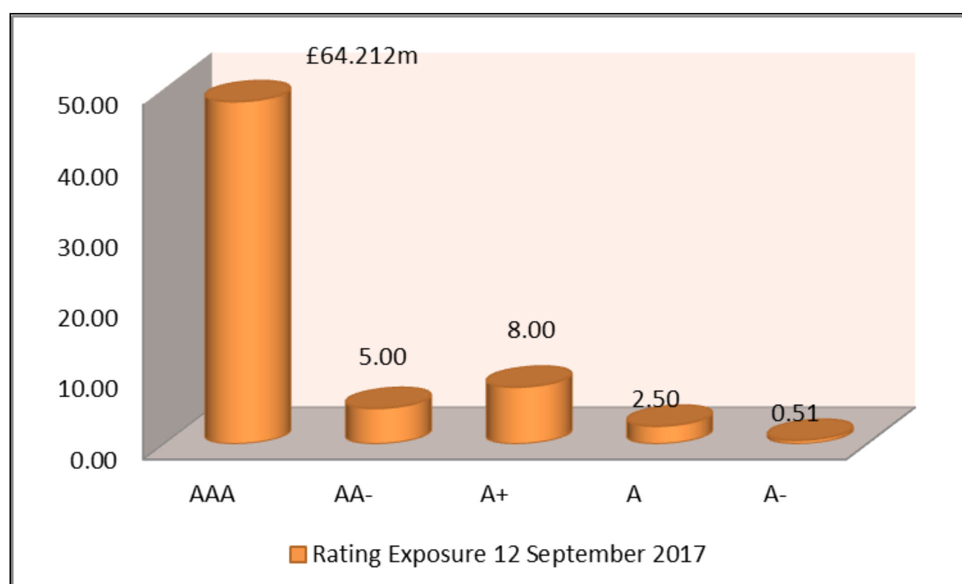
No other approved limits have been exceeded.

The budgeted investment return for 2017-18 is £0.064m. Although the rate of return is higher than the performance benchmark, for the year to date, the forecast is currently not expected to earn this. This is because there have been lower levels of surplus to invest and the rates available for immediate access have continued to fall.

5.1 Investment Counterparty criteria

The Commissioner's investment policy has regard to the Department for Communities & Local Government's (CLG) and the revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sector Guidance Notes ("the CIPFA TM Code"). The continuing potential for a re-emergence of a Eurozone sovereign debt crisis together with other risks which could impact on the creditworthiness of banks, prompts a low risk strategy. Given this risk environment, investment returns are likely to remain low. Therefore the Commissioner's investment priorities in order of importance will be security, liquidity and return.

The maximum exposure to the investment markets in the year to date was the 12 September 2017, when £64.21m (as a result of Police Grant, Top-Up Grant and Precept) was placed within the markets. The following graph demonstrates the quality of counterparties:



5.2 Creditworthiness policy

The Chief Financial Officer will maintain a counterparty list in compliance with the following criteria and will revise the criteria and submit them to the Commissioner for approval as necessary. The minimum rating criteria uses the lowest common denominator method of selecting counterparties and applying limits. There are no changes to the counterparty list proposed.

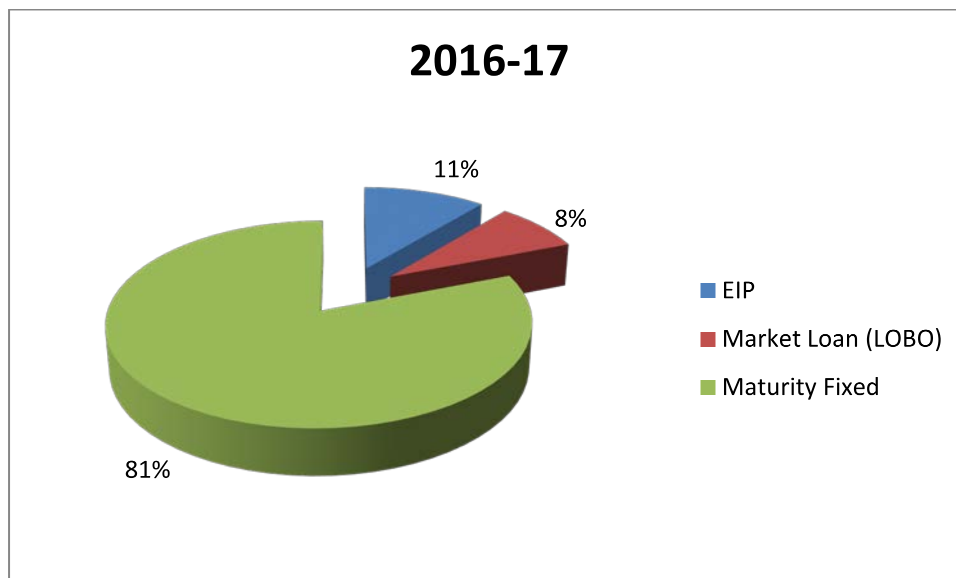
	Fitch Long term Rating (or equivalent)	**Value Limit**	**Time Limit**
Banks 1 higher quality	AAA	£5m	1 yr
Banks 1 medium quality	AA-	£5m	1 yr
Banks 1 medium / lower quality	A	£4m	6 months
Banks 1 lower quality	A-	£3m	100 days
Banks 2 — part nationalised	N/A	£5m	1yr
Limit 3 category — Commissioners banker (not meeting Banks 1)	AA	£5m	1 day
UK Govt - DMADF	AAA	Unlimited	6 months
Local authorities	N/A	£5m	2 yrs
Enhanced money market funds with instant access	AAA	£10/£15m	liquid
Enhanced money market funds with notice	AAA	£3-5m	liquid

6 Borrowing

The capital financing requirement (CFR) for 2017-18 is £59.775m which is not adequate with current spending and financing plans. The main reason for this is that capital receipts are being accumulated to be applied to future major projects. It needs to be increased to £61.000m

The CFR denotes the underlying need to borrow for capital purposes. If the CFR is positive monies may be borrowed (external borrowing) or from internal balances on a temporary basis (internal borrowing). The balance of external and internal borrowing is generally driven by market conditions and level of reserves. The table below shows activity on borrowings for the first half year.

	Position @ 01/04/17 £m	Loans taken £m	Loans repaid £m	Position @ 30/09/17 £m
Long Term Borrowing				
PWLB	33.204	0.000	-0.550	32.654
LOBO	3.500	0.000	0.000	3.500
Local Authorities	4.000	0.000	0.000	4.000
Total Long Term Borrowing	40.704	0.000	-0.550	40.154
Temporary Borrowing				
Local Authorities	0.000	11.500	-1.500	10.000
Banks & Other Institutions	0.000	0.000	0.000	0.000
Total Temporary Borrowing	0.000	11.500	-1.500	10.000
Total Borrowing	**40.704**	**11.500**	**-2.050**	**50.154**



By the year end it is anticipated that there will be external borrowing of £45.153m compared to a CFR of £60.987m. The remainder will be utilisation of internal balances.

No new borrowing has been undertaken up until the time of writing (14 November). There were no opportunities for debt rescheduling in the first half year. This is regularly reviewed for saving opportunities. It is anticipated that borrowing of £5.5m will be taken during the latter half of the year for the capital programme, if it is in line with the current forecast. A further £2.5m is required to replace debt maturing. The actual amounts borrowed and the timing thereof is in the judgement of the CFO with due regard to market conditions. Interest rates remain low across all PWLB bands with prospects of a rise in base rates not on the short term horizon.

	1 Year	5 Year	10 Year	25 Year	50 Year
Low	0.8	1.14	1.78	2.52	2.25
Date	03/05/2017	15/06/2017	15/06/2017	08/09/2017	08/09/2017
High	1.16	1.62	2.22	2.83	2.57
Date	15/09/2017	28/09/2017	28/09/2017	07/07/2017	07/07/2017
Average	0.9408	1.2981	1.9470	2.6475	2.3917

7 Review of Minimum Revenue Provision Policy Statement Interpretation

7.1 Introduction

The Commissioner's Office repays each year part of the accumulated capital spend (CFR) through a revenue charge (MRP). An additional voluntary payment may also be made (VRP). A VRP of £0.750m was made in 2016-17 The MRP can be calculated in various ways but the overarching principles are that the repayment must be prudent and affordable.

7.2 The Stated Policy

The existing policy was approved by The Commissioner on 14 February 2017 and is as follows:

The Commissioner will set aside an amount for MRP each year, which is deemed to be both prudent and affordable. This will be after considering statutory requirements and relevant guidance from the DCLG.

Repayments included in annual PFI or finance leases are applied as MRP.

It is considered that this policy is both prudent and affordable, therefore no changes are proposed.