For Information / Approval	
Public/Non Public*	**Public**
Report to:	**Joint Audit and Scrutiny Panel**
Date of Meeting:	**November 2018**
Report of:	**Chief Finance Officer**
Report Author:	**Charlotte Radford**
Other Contacts:	**Amanda Harlow**
Agenda Item:	**13**

Mid-Year Treasury Management Report 2018-19

1. Purpose of the Report

1.1 To provide members with the mid-year position of the treasury management performance compared with the approved strategy.

2. Recommendations

2.1 Members are recommended to approve the increase relating to the minimum availability of fund from £2 million to £5 million.

3. Reasons for Recommendations

3.1 This complies with good financial governance.

4. Summary of Key Points

4.1 The Treasury Management Strategy Statement (TMSS) for 2018-19 was approved by the Commissioner on 13 February 2018 (Decision record 2018.008). There was also a further decision record on the 14th September 2018 (Decision record 2018.068). This amended 4.2 of the strategy as follows:

- Increase the amount limit for short term loans to Local Authorities from £5 million to £8 million
- Increase the limit of Low Volatility Net Asset Value Funds without reference to the CFO from £10 million to £12 million

4.2 The latest recommendation has arisen as the £2 million minimum limit for availability of liquid funds has been unchanged for a number of years and it is therefore prudent to increase this, particularly as there is no longer an authorised bank overdraft and cash flow can be volatile.

4.2 Detail of performance against the Prudential and Treasury management indicators is provided in **Appendix A**.

5. Financial Implications and Budget Provision

5.1 None as a direct result of this report.

6. Human Resources Implications

6.1 None as a direct result of this report.

7. Equality Implications

7.1 None as a direct result of this report.

8. Risk Management

8.1 None as a direct result of this report.

9. Policy Implications and links to the Police and Crime Plan Priorities

9.1 This report complies with good governance and financial regulations.

10. Changes in Legislation or other Legal Considerations

10.1 None

11. Details of outcome of consultation

11.1 Not applicable

12. Appendices

12.1 Appendix A – Treasury Management Mid-Year Review

Nottinghamshire
POLICE & CRIME COMMISSIONER

Treasury Management Strategy Statement Mid-year Review Report 2018-19

Incorporating Review of Minimum Revenue Provision Policy and Annual Investment Strategy

Contents

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 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 (CFOPCC).

2 Introduction

The Commissioner complies with the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management. Accordingly this defines treasury management as:

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 Prudential Code 2017 introduced a new requirement for local authorities to produce an annual Capital Strategy; this will be produced in a separate report.

This code also required more information over longer time scales on significant non-financial investments such as property and other commercial activities. The Chief Financial Officer does not consider that these type of investments, with significantly higher risks are appropriate for the Nottinghamshire Office of the Police and Crime Commissioner. Hence no additional indicators are required.

3 Economic update

3.1 Economic performance to date and outlook

3.1.1 U.K.

The UK in the first half of 2018-19 had modest economic growth, robust enough for the Monetary Policy Committee, (MPC), to unanimously vote to increase the Bank Rate on 2nd August from 0.5% to 0.75%. Although growth looks as if it will only be modest at around 1.5% in 2018, the Bank of England's August Quarterly Inflation Report forecast that growth will pick up to 1.8% in 2019. This depends on an orderly Brexit arrangement.

Some MPC members have expressed concerns about a build-up of inflationary pressures, particularly with the pound losing value against both the US dollar and the Euro. The Consumer Price Index (CPI) rose unexpectedly from 2.4% in June to 2.7% in August due to increases in volatile components, but is expected to fall back to the 2% inflation target over the next two years assuming modest increases in Bank Rate. The MPC has indicated Bank Rate would need to be in the region of 1.5% by March 2021 for inflation to stay on track. Financial markets are currently pricing in the next increase in Bank Rate for the second half of 2019.

Unemployment has continued at a 43 year low of 4%. A combination of job vacancies hitting an all-time high in July, together with negligible growth in total employment numbers, indicates that employers are now having major difficulties filling job vacancies with suitable staff. As a consequence wage inflation increased to 2.9%.An increase in household spending power is likely to provide some support to the overall rate of economic growth in the coming months

There is a risk that the current Conservative minority government may be unable to muster a majority in the Commons on Brexit. The most likely outcome is that Prime Minister May's government will endure, despite various setbacks, along the route to Brexit in March 2019. A general election in the next 12 months could result in a potential loosening of monetary policy and therefore medium to longer dated gilt yields could rise on the expectation of a weak pound and concerns around inflation would increase.

3.1.2 U.S.A.

The massive easing of fiscal policy is fuelling a (temporary) boost in consumption which has generated an upturn in the rate of strong growth which rose from 2.2%, (annualised rate), in quarter 1 to 4.2% in quarter 2, coupled with an upturn in inflationary pressures. Inflation is moving towards 3%, the Federal bank (Fed) increased rates another 0.25% in September to between 2.00% and 2.25%, this being four increases in 2018, and indicated they expected to increase rates four more times by the end of 2019. The issue is what to do when the temporary boost to consumption wanes. A building trade war with China would invariably make any easing of monetary policy harder for the Fed in the second half of 2019.

3.1.3 Eurozone

Growth was unchanged at 0.4% in quarter 2, much lower than forecasts for a stronger economic performance in 2018. In particular, data from Germany has been mixed and it could be further negatively impacted by expected US tariffs on exported cars. Forecasts for 2019 have been downgraded.

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. There is also concerns regarding 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 has provided the following forecast.

Link Asset Services Interest Rate View											
	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
Bank Rate View	0.75%	0.75%	0.75%	0.75%	1.00%	1.00%	1.00%	1.25%	1.25%	1.50%	1.50%
3 Month LIBID	0.75%	0.80%	0.80%	0.90%	1.10%	1.10%	1.20%	1.40%	1.50%	1.60%	1.60%
6 Month LIBID	0.85%	0.90%	0.90%	1.00%	1.20%	1.20%	1.30%	1.50%	1.60%	1.70%	1.70%
12 Month LIBID	1.00%	1.00%	1.00%	1.10%	1.30%	1.30%	1.40%	1.60%	1.70%	1.80%	1.80%
5yr PWLB Rate	2.00%	2.00%	2.10%	2.20%	2.20%	2.30%	2.30%	2.40%	2.50%	2.50%	2.60%
10yr PWLB Rate	2.40%	2.50%	2.50%	2.60%	2.70%	2.70%	2.80%	2.90%	2.90%	3.00%	3.10%
25yr PWLB Rate	2.80%	2.90%	3.00%	3.10%	3.10%	3.20%	3.30%	3.30%	3.40%	3.50%	3.50%
50yr PWLB Rate	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.10%	3.10%	3.20%	3.30%	3.30%

The 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 above forecast shows a steady incline in interest rates over the coming years. The flow of generally positive economic statistics after the end of the quarter ended 30 June underpinned the increase in Bank Rate above to 0.75%. However, the MPC assured that increases would be gradual and would rise to a neutral point, not intended to expand or contract the economy. This was indicated to be around 2.5% in ten years' time but they declined to give a medium term forecast. Further increases are not expected prior to Brexit in March 2019, and are most likely to be in August 2019. Further increases will be at a cautious pace, in line with economic performance.

The overall balance of risks to economic recovery in the UK has improved to be neutral.

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.

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 2018-19 was approved by the Commissioner on 13 February 2018 (Decision record 2018.008). There was also a further decision record on the 14th September 2018 (Decision record 2018.068) This amended 4.2 of the strategy as follows:

- Increase the amount limit for short term loans to Local Authorities from £5 million to £8 million
- Increase the limit of Low Volatility Net Asset Value Funds without reference to the CFO from £10 million to £12 million

A further amendment is recommended to the Strategy regarding the minimum availability of liquid funds. This has been set at £2 million for a number of years and it is considered prudent to increase this to £5 million particularly as there is no longer an authorised bank overdraft and cash flows can be volatile.

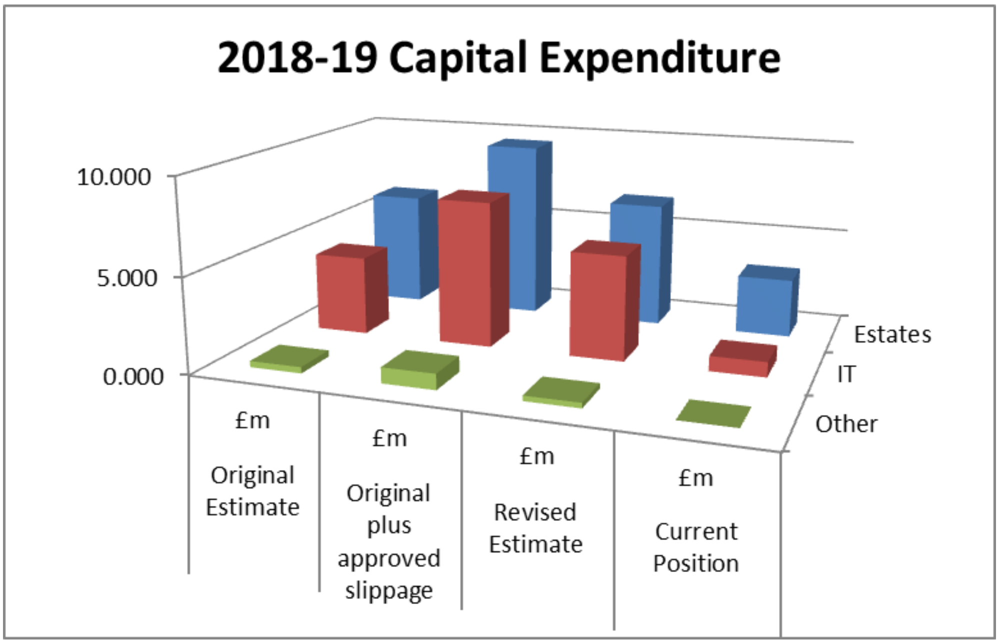
4.1 Prudential Indicator for Capital Expenditure and Financing

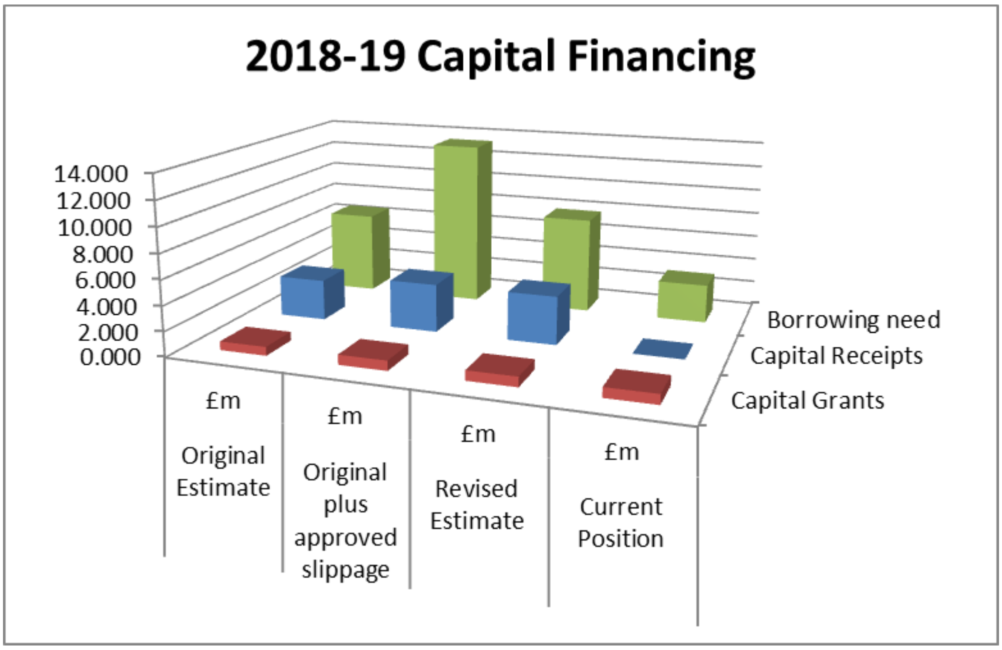
This table shows the revised estimates for capital expenditure and the changes since the capital programme was agreed at the Budget. It also shows the anticipated method of financing.

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 2018-19 by Service

	Original Estimate £m	Original plus approved slippage £m	Current Position £m	Revised Estimate £m
Estates	6.137	9.490	3.115	6.655
IT	4.188	7.745	0.799	5.534
Other	0.327	0.832	0.000	0.276
Total	**10.652**	**18.067**	**3.914**	**12.465**
Financed by:				
Capital Receipts	3.293	3.886	0.006	3.886
Capital Grants	0.700	0.793	0.793	0.793
Total Financing	**3.993**	**4.679**	**0.799**	**4.679**
Borrowing need	**6.659**	**13.388**	**3.115**	**7.786**


2018-19 Capital Expenditure
10.000
5.000
0.000
£m
Original Estimate
£m
Original plus approved slippage
£m
Revised Estimate
£m
Current Position
Estates
IT
Other


2018-19 Capital Financing
14.000
12.000
10.000
8.000
6.000
4.000
2.000
0.000
£m
Original Estimate
£m
Original plus approved slippage
£m
Revised Estimate
£m
Current Position
Borrowing need
Capital Receipts
Capital Grants

4.2 Prudential Indicator Monitoring

	2017-18 Authority Approved Indicator	2017-18 Outturn @ 31-03-18	2018-19 Authority Approved Indicator	2018-19 Estimate Outturn @ 30-09-18
Section 1 - Indicators Based on Expected Outcomes **Affordability:**				
Ratio of Financing Costs to Net Revenue Stream (%)	**2.8**	**2.1**	**2.1**	**0.4**
Incremental Impact of Capital Investment Decisions on Band D Council Tax	**£3.82**	**-**	**£1.20**	**£0.72**
Actual Capital Expenditure 30-09-18 (£m)	**-**	**-**	**-**	**3.914**
Estimated Capital Expenditure 30-09-18 (£m)	**-**	**-**	**10.652**	**12.465**
Capital Financing Requirement (£m)	**60.899**	**59.137**	**68.851**	**64.507**
Section 2 - Indicators Based on Limits **Affordability:**				
Actual External Debt 30-09-18 (£m)	**-**			**48.755**
Estimated External Debt 31-03-19 (£m)	**-**	**44.303**	**48.720**	**42.285**
Authorised Limit for External Debt (£m)	**80.000**	**-**	**80.000**	**-**
Operational Boundary for External Debt (£m)	**70.000**	**-**	**70.000**	**-**
Prudence:				
Gross Debt & CFR (£m)	**61.579**	**74.797**	**72.227**	**72.293**

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 as at 30 September 2018. This is currently within the approved indicator.

A key control over treasury activity is a prudential indicator to ensure that over the medium term, borrowing 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. The operational boundary is the limit beyond which external debt is not normally expected to exceed. 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 0.5%/0.75% 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 £46.400m of investments as at 30 September 2018 (£9.800m at 31 March 2018) and the weighted investment portfolio yield for the first six months of the year is 0.53% against a benchmark (7 day LIBID) of 0.58%

	Position @ 01-04-18 £m	Investments made £m	Investments withdrawn £m	Position @ 30-09-18 £m
Temporary Investment				
Banks	0.000	(4.000)	0.000	(4.000)
Building Societies	0.000	0.000	0.000	0.000
Local Authorities	0.000	(52.000)	10.000	(42.000)
MMF	(9.800)	(132.300)	141.700	(0.400)
Total Investment	**(9.800)**	**(188.300)**	**151.700**	**(46.400)**

Investment:

	Position @ 01-04-18 £m	Investments made £m	Investments withdrawn £m	Position @ 30-09-18 £m
Fixed Term Investment	0.000	(52.000)	10.000	(42.000)
Variable Term Investment	(9.800)	(136.300)	141.700	(4.400)
	(9.800)	**(188.300)**	**151.700**	**(46.400)**

Proportion of Fixed Term Investment held	90.52%
Proportion of Variable Term Investment held	9.48%

The main investment type employed by the Commissioner is Low Volatility Net Asset Value Funds (LVNAV). 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 limits in the investment policy for LVNAVs are for £12m, 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 has been 26 days when an LVNAV fund balance has been over £12m and up to £15m. There have been 14 days when this has been over £15m, with the consent of the CFO. The maximum value has been £18m in one fund. One option to alleviate this situation would be to open a new LVNAV, but this is not really widening the portfolio any further, as comparisons of where the LVNAVs invest show a high degree of overlap.

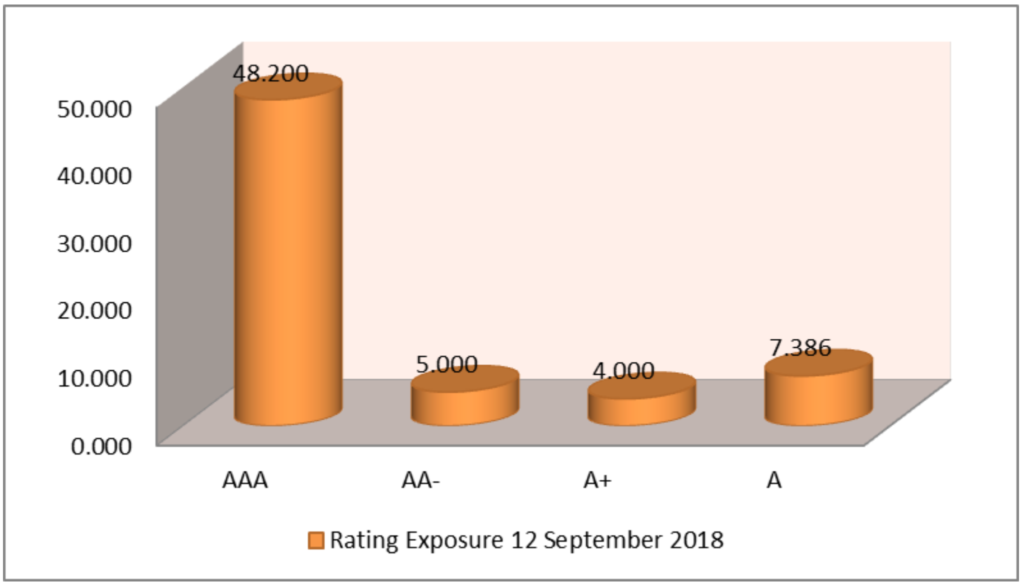
No other approved limits have been exceeded.

The budgeted investment return for 2018-19 is £0.198m. Although the rate of return is lower than the performance benchmark (7 day LIBID), for the year to date, the forecast is currently expected to earn this. This is because there have been higher levels of surplus to invest and the rates available for fixed term investments have been stable.

5.1 Investment Counterparty criteria

The Commissioner's investment policy has regard to the Ministry for Housing, Communities & Local Government's (MHCLG) 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 12th September 2018, when £64.586m (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

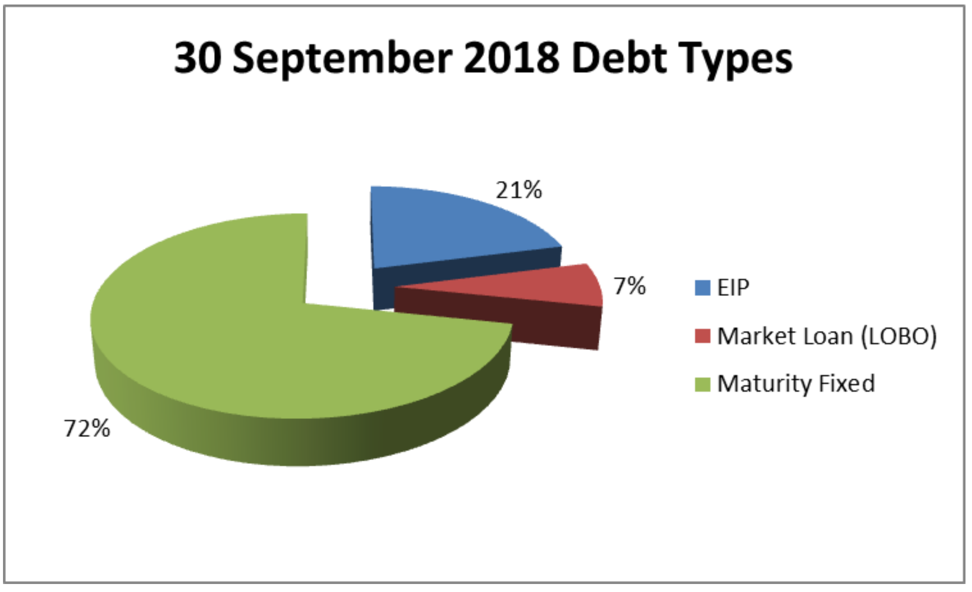
The Chief Financial Officer will maintain a counterparty list in compliance with the following criteria and will revise the criteria and submit them to the Commissioner for approval as necessary. The minimum rating criteria uses the lowest common denominator method of selecting counterparties and applying 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 year
Banks 1 medium quality	AA-	£5m	1 year
Banks 1 medium / lower quality	A	£4m	6 months
Banks 1 lower quality	A-	£3m	100 days
Banks 2 — part nationalised	N/A	£5m	1 year
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 £8m	1-2 yrs Up to 1 year
Low Volatility Net Asset Value Fund	AAA	£12/£15m	liquid
Ultra Short Dated Bond Funds	AAA	£3-5m	liquid

6 Borrowing

The capital financing requirement (CFR) for 2018-19 is £xm. 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.

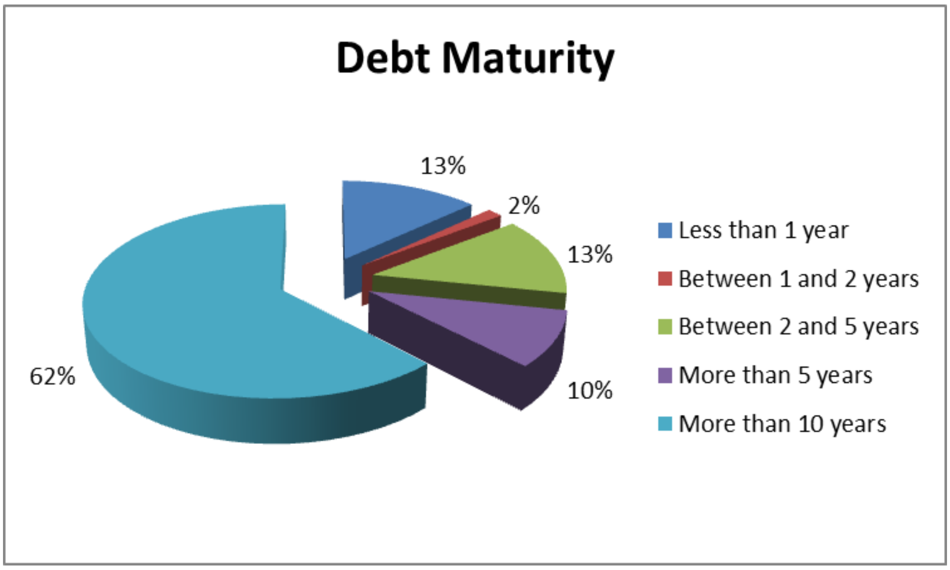
	Position @ 01-04-18 £m	Loans taken £m	Loans repaid £m	Position @ 30-09-18 £m
Long Term Borrowing				
PWLB	29.605	10.000	(0.350)	39.255
LOBO	3.500	0.000	0.000	3.500
Local Authorities	4.000	0.000	0.000	4.000
Total Long Term Borrowing	37.105	10.000	(0.350)	46.755
Temporary Borrowing				
Local Authorities	0.000	8.500	(6.500)	2.000
Banks & Other Institutions	0.000	0.000	0.000	0.000
Total Temporary Borrowing	0.000	8.500	(6.500)	2.000
Total Borrowing	**37.105**	**18.500**	**(6.850)**	**48.755**



By the year end it is anticipated that there will be external borrowing of £42.285m compared to a CFR of £64.507m. The remainder will be via utilisation of internal balances.

New borrowing has been undertaken as follows:
Borrowing of £10m from PWLB was undertaken in August, consisting of both EIP and fixed rate maturity loans in line with maturity structure of borrowing. 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
3.4.18	**1.48%**	**1.84%**	**2.22%**	**2.55%**	**2.27%**
30.9.18	**1.55%**	**1.93%**	**2.33%**	**2.74%**	**2.56%**
Low	**1.28%**	**1.67%**	**2.09%**	**2.50%**	**2.25%**
Date	**01/06/2018**	**29/05/2018**	**20/07/2018**	**20/07/2018**	**29/05/2018**
High	**1.57%**	**1.99%**	**2.43%**	**2.83%**	**2.64%**
Date	**17/04/2018**	**25/09/2018**	**25/04/2018**	**25/09/2018**	**25/09/2018**
Average	**1.46%**	**1.84%**	**2.25%**	**2.64%**	**2.41%**



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 £0.250m was made in 2017-18 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 13 February 2018 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.