For Information & Decision	
Public/Non Public*	**Public**
Report to:	**Strategic Resources and Performance Meeting**
Date of Meeting:	**20th November 2013**
Report of:	**The Chief Finance Officer**
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Agenda Item:	**8**

MID-YEAR TREASURY MANGEMENT REPORT 2013-14

1. Purpose of the Report

1.1 This report complies with the Code of Practice in relation to Treasury Management and the Prudential Indicators. The report provides an update on the performance against the approved indicators for Treasury activity and the Prudential Indicators.

2. Recommendations

2.1 To approve two amendments to the Counterparty list criteria within the Treasury Management Strategy:

- That ‘A’ rated banks with a current limit of 1 month is increased to 100 days
- That other Local Authorities with a current limit of 1 year is increased to 3 years

2.2 To note the information provided within the report.

3. Reasons for Recommendations

3.1 Good financial management and governance.

4. Summary of Key Points

4.1 In compliance with the CIPFA code of practice for treasury management this report summarises the economic outlook which affects the markets and therefore the performance of the Commissioners investments and borrowing requirements.

4.2 The report also provides the mid year position against the treasury and prudential indicators set within the Treasury Management Strategy. This clearly shows that we are operating well within the limits set and that no further borrowing has been undertaken due to slippage in the capital programme. It is planned that a further £7million of capital expenditure will be utilised in the second half of this financial year.

4.3 The investment rates for our short term balances have dropped significantly during the year and together, with our reducing use of internal balances to finance capital does provide an increased risk. However, the Counterparties list is automatically updated with the changes in banks and approved institutions rating. To ensure we are only transacting business with those institutions that meet our criteria.

4.4 However, during the year there are occasions when the balance we hold is more than can be invested in the approved counterparties and there specific limits. On these occasions the CFO has to approve increasing the limits for short periods of time. The number of occasions that CFO approval has been given is increasing as the number of eligible counterparties reduces. It is therefore recommended that:

- ‘A’ rated banks with a current limit of 1 month is increased to 100 days as this will make more accounts available to use allowing a spread of investments and without increasing the risk.
- Other Local Authorities with a current limit of 1 year is increased to 3 years. Local authorities are not likely to default on repayment and are backed by rate payers and the government.

4.5 Overall, the performance of investments is better than the market average whilst still ensuring the security of our financial assets.

4.6 Expenditure within the capital programme is very low in the first half of the year and this is reflected in that no borrowing for capital expenditure has yet taken place. However, activity within the capital programme is anticipated to increase in the second half of the year and borrowing will take place as required.

4.7 However, we have taken advantage of some debt rescheduling allowing us to achieve some modest savings against the cost of borrowing.

5. Financial Implications and Budget Provision

5.1 None as a direct result of this report but the rescheduling of debt has delivered a saving of £17,000 in this financial year.

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 There are clearly risks in relation to treasury management activity. However, these are managed through compliance with the treasury management strategy. The staff involved in this activity are aware of the need to ensure security of investments above the rate of return.

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

9.1 This report requests an amendment to the approved Treasury Management Strategy for 2013-14.

10. Changes in Legislation or other Legal Considerations

10.1 We are compliant with the updated guidance issued by CIPFA.

11. Details of outcome of consultation

11.1 Not applicable

12. Appendices

12.1 1 – Mid Year review report 2013-14
2 – Summary of Prudential Indicator Monitoring

Appendix 1

Nottinghamshire
POLICE & CRIME COMMISSIONER

Treasury Management Strategy Statement and Annual Investment Strategy

Mid-year Review Report 2013-2014

1 Background

The Police and Crime Commissioner (Commissioner) operates a balanced budget, which broadly means cash raised during the year will meet its cash expenditure. The treasury management strategy ensures that cash flow is adequately planned. Surplus monies are invested in low risk counterparties, providing adequate liquidity before optimising investment return is considered.

The second main function of the treasury management service is the funding of the Commissioner's capital plans. This provides a guide to the borrowing need of the Commissioner, essentially the longer term cash flow planning to ensure the Commissioner can meet his capital spending operations. 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 the Commissioner's 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."

2 Introduction

The Commissioner follows the Chartered Institute of Public Finance & Accountancy Code of Practice on Treasury Management, revised 2011 (Code).

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 the Commissioner's treasury management activities.
- Creation and maintenance of Treasury Management Practices which set out the manner in which the Commissioner will seek to achieve those policies and objectives.
- Receipt by the Commissioner of an annual Treasury Management Strategy Statement - including the Annual Investment Strategy and Minimum Revenue Provision Policy - for the year ahead, a Mid-year Review Report and an Annual Report covering activities during the previous year.
- Delegation by the Commissioner of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions. This is delegated to his Chief Financial Officer.
- Delegation by the Commissioner of the role of scrutiny of treasury management strategy and policies to a specific named body. The Commissioner has delegated this to the Office of the Police & Crime Commissioner:

This mid-year report has been prepared in compliance with this Code, and covers the following:

- An economic update for the 2013-2014 financial year to 30 September 2013.
- A review of the Treasury Management Strategy Statement and Annual Investment Strategy Statement.
- The Commissioner's prudential indicators for capital expenditure.
- A review of the Commissioner's investment portfolio for 2013-2014.
- A review of the Commissioner's borrowing strategy for 2013-2014.
- A review of any debt rescheduling undertaken during 2013-2014.
- A review of compliance with Treasury and Prudential Limits for 2013-2014.

3 Economic update

3.1 Economic performance to date

During 2013-2014 economic indicators suggested that the economy is recovering, albeit from a low level. After avoiding recession in the first quarter of 2013, with a 0.3% quarterly expansion the economy grew 0.7% in quarter 2. There have been signs of renewed vigour in household spending in the summer, with a further increases in retail sales, mortgages, house prices and new car registrations.

The strengthening in economic growth appears to have supported the labour market, with employment rising at a modest pace with prospects of further reductions. Pay growth also rebounded strongly in April, though this was mostly driven by high earners delaying bonuses until after April's cut in the top rate of income tax. Excluding bonuses, earnings rose by just 1.0% year on year, well below the rate of inflation at 2.7% in August, causing continuing pressure on household disposable income.

The Bank of England extended its 'Funding for Lending' Scheme into 2015 and sharpened the incentives for banks to extend more business funding, particularly to small and medium size enterprises. To date, the mortgage market still appears to have been the biggest beneficiary from the scheme, with mortgage interest rates falling to new lows. Together with the Government's 'Help to Buy scheme', which provides equity loans to credit-constrained borrowers, this is helping to boost demand in the housing market. Mortgage approvals by high street banks have risen also, but they are still well down from pre 2008.

With regards to the fiscal situation, the public borrowing figures continued to be distorted by a number of one-off factors. On an underlying basis, borrowing in Q2 reduced slowly, as Government expenditure cuts took effect and economic growth started to become evident through a small increase in tax receipts. The 2013 Spending Review, covering only 2015-2016, made no changes to the headline Government spending plan, and monetary policy was unchanged in advance of the new Bank of England Governor, Mark Carney, arriving. Bank Rate remained at 0.5% and quantitative easing (QE) also stayed at £375bn. In August, the Monetary Policy Committee (MPC) indicated that the Bank Rate is unlikely to be reviewed until unemployment falls to 7%, which is predicted to be mid 2016. The three month to July average unemployment rate was 7.7%. Consumer Price Index inflation (MPC target of 2.0%), fell marginally from a peak of 2.9% in June to 2.7% in August. The Bank of England expects inflation to fall back to 2.0% in 2015.

The UK economy continues to be influenced by the US economy. Financial markets sold off sharply following comments from the Fed chairman in June that suggested the Federal Reserve (Fed) could reduce QE earlier than anticipated. The resulting rise in US Treasury yields was replicated in the UK. Equity prices fell initially too, as the purchasing of bonds by the Fed has underpinned investor moves into equities out of low yielding bonds. As the market moves to realign its expectations, bond yields and equities are likely to rise further in expectation of a continuing economic recovery. Increases in US payroll figures have shown further improvement, helping to pull the unemployment rate down from a high of 8.1% to 7.3%, and continuing house price rises have helped more households to escape from negative equity. In September, the Fed surprised financial markets by not reducing QE, due to a series of weak economic data in recent months. Bond yields fell sharply as a result, though it still only remains a matter of time until tapering does start.

Tensions in the Eurozone eased over the second quarter, but there remained a number of triggers for a renewed flare-up. Economic survey data improved consistently over the first half of the year, pointing to a return to growth in quarter 2, so ending six quarters of Eurozone recession.

3.2 Outlook for the next six months of 2013-2014

Economic forecasting remains difficult with so many external influences to the UK. Volatility in bond yields are likely, as market confidence ebbs and flows between the riskier assets i.e. equities, and safer bonds.

Downside risks to UK gilt yields and Public Works Loans Board (PWLB) rates include:

- A return to weak economic growth in the US, UK and China causing major disappointment to investor and market expectations.
- The potential for a significant increase in negative reactions by citizens of Eurozone countries against austerity programmes, especially in countries with very high unemployment rates such as Greece and Spain. They face huge challenges in achieving economic growth.
- The Italian political situation is frail and unstable following the collapse of the coalition government on 29 September.

- Problems in other Eurozone heavily indebted countries such as Cyprus and Portugal, which could also generate safe haven flows into UK gilts.
- Monetary policy action failing to stimulate sustainable growth in western economies, especially the Eurozone and Japan.
- Weak growth or recession in the UK's main trading partners - the EU and US, depressing economic recovery in the UK.
- Geopolitical risks in countries such as Syria, Iran, North Korea, which could trigger safe haven flows back into bonds.

Upside risks to UK gilt yields and PWLB rates (especially longer term) include:

- UK inflation being significantly higher than in the wider EU and US, causing an increase in the inflation premium inherent to gilt yields.
- Increased investor confidence in sustainable robust world economic growth, together with a reduction or end of QE operations in the US, causing a further flow of funds out of bonds into equities.
- A reversal of Sterling's safe-haven status because of a sustainable improvement in financial stresses in the Eurozone.
- In the longer term - a reversal of QE in the UK.
- Further downgrading by credit rating agencies of the creditworthiness and credit rating of UK Government debt. This would happen if economic growth measures are not successful. The ratio of Government debt to Gross Domestic Product would rise.

The overall balance of risks to economic recovery in the UK is now weighted to the upside after five months of economic improvements. However it remains vulnerable in a number of key areas. The long-term trend is for gilt yields and PWLB rates to rise, due to the high volume of gilt issued in the UK and other major western countries. In the short term there is some risk of further QE if growth dips or if action is taken to combat market expectations of an early first increase in Bank Rate. An increase in QE (especially up to 10 years) this could cause gilt yields and PWLB rates over the next year or two to be significantly lower than the forecasts in the table below. Tensions in the US over the Federal budget for the new financial year starting on 1 October and raising the debt ceiling in mid October may also see bond yields dip until agreement is reached.

3.3 Interest rate forecasts (Certainty Rates) provided by Capita Asset services

	Sep-13	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17
Bank rate	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%	1.00%	1.25%
5yr PWLB rate	2.50%	2.50%	2.50%	2.60%	2.70%	2.70%	2.80%	2.80%	2.90%	3.00%	3.20%	3.30%	3.50%	3.60%	3.70%
10yr PWLB rate	3.70%	3.70%	3.70%	3.70%	3.80%	3.80%	3.90%	4.00%	4.10%	4.20%	4.30%	4.40%	4.50%	4.60%	4.60%
25yr PWLB rate	4.40%	4.40%	4.40%	4.40%	4.50%	4.50%	4.60%	4.70%	4.80%	4.90%	5.00%	5.10%	5.10%	5.10%	5.20%
50yr PWLB rate	4.50%	4.40%	4.40%	4.40%	4.50%	4.60%	4.70%	4.80%	4.90%	5.00%	5.10%	5.20%	5.20%	5.20%	5.30%

The key to predicting the first increase in UK Bank Rate is linked to forecasting when unemployment is going to fall to 7%. Financial markets have aggressively raised short term interest rates and gilt yields considering that the strength of economic recovery will cause unemployment to fall much faster than the Bank of England forecasts. They predict that the first increase in Bank Rate will be in quarter 4 of 2014. The argument against this view is that the economic downturn since 2008 was unusual because unemployment did not rise to predicted levels. This meant that labour was retained, causing inefficiencies. The MPC expects unemployment to fall slowly as existing labour levels are worked more intensively and productivity increases. Also there are many currently self employed or part time employed workers who are seeking full time employment. Capita Asset Services supports the MPC view as more realistic. The prospects for any increase in Bank Rate before 2016 are therefore unlikely. Other more pessimistic forecasters do not expect the first increase in Bank Rate until Spring 2017.

4 Treasury Management Strategy Statement and Annual Investment Strategy update

The Treasury Management Strategy Statement (TMSS) for 2013-2014 was approved by this Commissioner January 2012. The policy has operated successfully during the first half year, however the investment risk has eased slightly and investment returns have reduced. The investment reductions are linked with Government liquidity limits for banks. After consultation with Capita the following amendments to the counter-party restrictions are recommended;

‘A’ Rated Banks currently 1 month **- recommended extending to 100 days**
Other Local Authorities currently 1 year **- recommended extending to 2 years**

5 The Commissioner's Capital Position (Prudential Indicators)

5.1 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 for the Budget. The increase in the Capital Expenditure Estimate is due to slippage of £3.8m from 2012-2013. It also demonstrates the impact on financing arrangements. The borrowing element of the table increases the underlying indebtedness of the Commissioner by way of the Capital Financing Requirement (CFR). This will be reduced by revenue charges for the repayment of debt (the Minimum Revenue Provision). This direct borrowing need may also be supplemented by maturing debt and other treasury requirements.

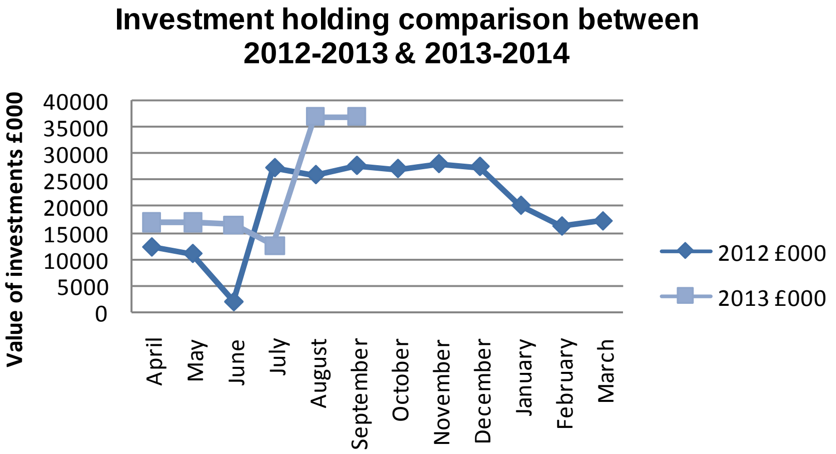
	2013-2014 Original Estimate	2013-2014 Current Position	2013-2014 Revised Estimate
	£m	£m	£m
Estates	3.909	0.386	5.067
IT	3.252	0.921	5.851
Other	0.695	0.309	0.708
Total	**7.856**	**1.616**	**11.626**
Financed by:			
Capital Receipts	1.658	0	1.658
Capital Grants	1.714	1.616	1.714
Capital Reserves	0	0	0
Revenue	0	0	0
Previously financed	0	0	3.770
Total Financing	**3.372**	**1.616**	**7.142**
Borrowing need	**4.484**	**0**	**4.484**

5.3 Prudential Indicators

Appendix 2 shows the prudential indicators for the year and an update on how they are performing. There are no areas of concern to report.

6. Investment Portfolio 2013-2014

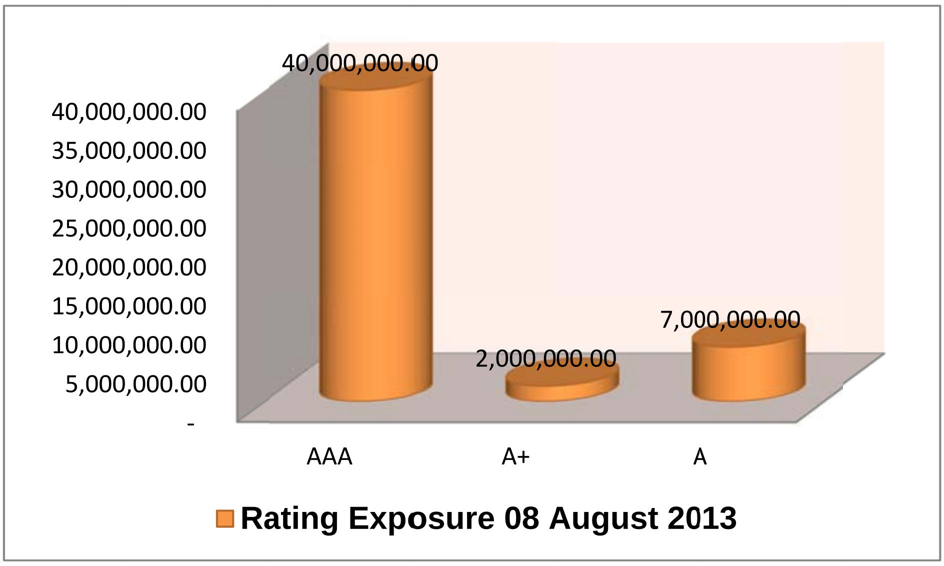
In accordance with the Code, the priority is to ensure the security of capital and liquidity, and to obtain an appropriate level of return which is consistent with the Commissioner's risk appetite. With a 0.5% Bank Rate it is impossible to achieve the returns of previous decades. Indeed the introduction of the Funding for Lending scheme has reduced market investment rates even further than last year. The economic situation, prompts a low risk, short term strategy. Investment returns are likely to remain low. The Commissioner's budgeted investment return for 2013-2014 is £0.188, and income for the year is currently forecast to be £0.156m (£0.190m actual 2012-2013) The holding of investments varies through the year in line with cash flow. Although cash invested has been higher the returns available have been lower. The investment yield for the first six months of the year is 0.56% has exceeded the average LIBID rate of 0.36%.



	Position @ 01/04/13 £000	Investments made £000	Investments withdrawn £000	Position @ 30/06/13 £000
<u>Temporary Investment</u>				
Banks	(7,000)	(4,920)	4,920	(7,000)
Building Societies	0	(2,000)	0	(2,000)
Local Authorities	(2,000)	0	0	(2,000)
MMF	(7,300)	(121,665)	110,615	(18,350)
Total Investment	**(16,300)**	**(128,585)**	**115,535**	**(29,350)**
Analysed as follows;				
Fixed Term Investment	(2,000)	(2,000)	0	(4,000)
Variable Term Investment	(14,300)	(126,585)	115,535	(25,350)
	(16,300)	**(128,585)**	**115,535**	**(29,350)**

Proportion of Fixed Term Investment held	13.63%
Proportion of Variable Term Investment held	86.37%

The Chief Financial Officer confirms that the approved limits within the Annual Investment Strategy were not breached during the first six months of 2013-2014. The quality of counterparties for investment is governed by the approved Treasury Management Strategy. No changes to this are recommended. This is monitored on a daily basis and an important part of this is the credit agency ratings. The maximum investment held during the first half of the year was £49m on 8 August 2013 when precept, pension top up grant and police grant had just been received. The following graph shows the exposure rating on that day:



The majority of investments are made in money market funds which all carry the highest security rating of AAA. Money market funds operate by spreading the risk across a wide range of counterparties, many of which are not available to the smaller investor. The impact of any counterparty failure is therefore minimised. It is also important that the Commissioner's investment forms a minor part of the overall fund. Information regarding the four being used is in the following table;

Money Market Funds

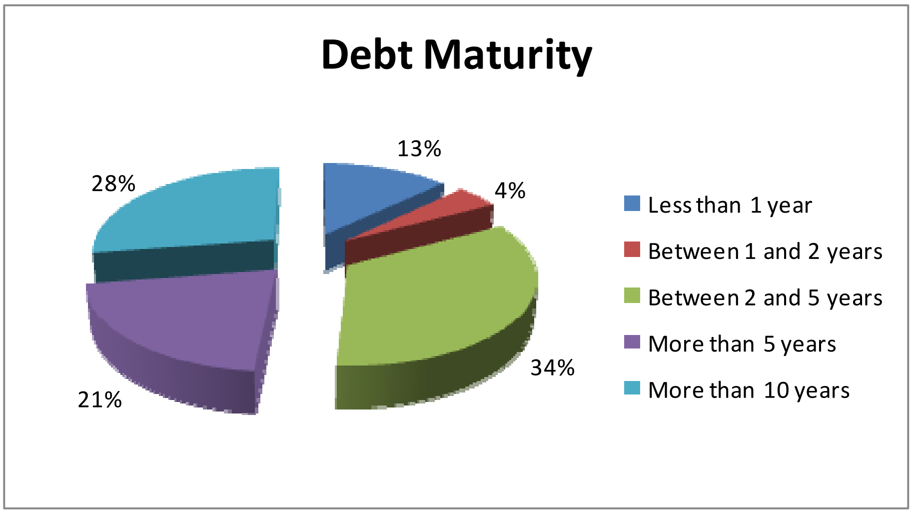
	Ignis	Federated Investors	Black Rock	Royal Bank of Scotland
Balance as at 30/9/13	7,000	7,000	4,300	50
Net Interest Rate as at 9/10/13	0.490%	0.480%	0.410%	0.340%
Percentage of Total Fund 9/10/13	0.077%	0.053%	0.034%	0.188%

7 Borrowing

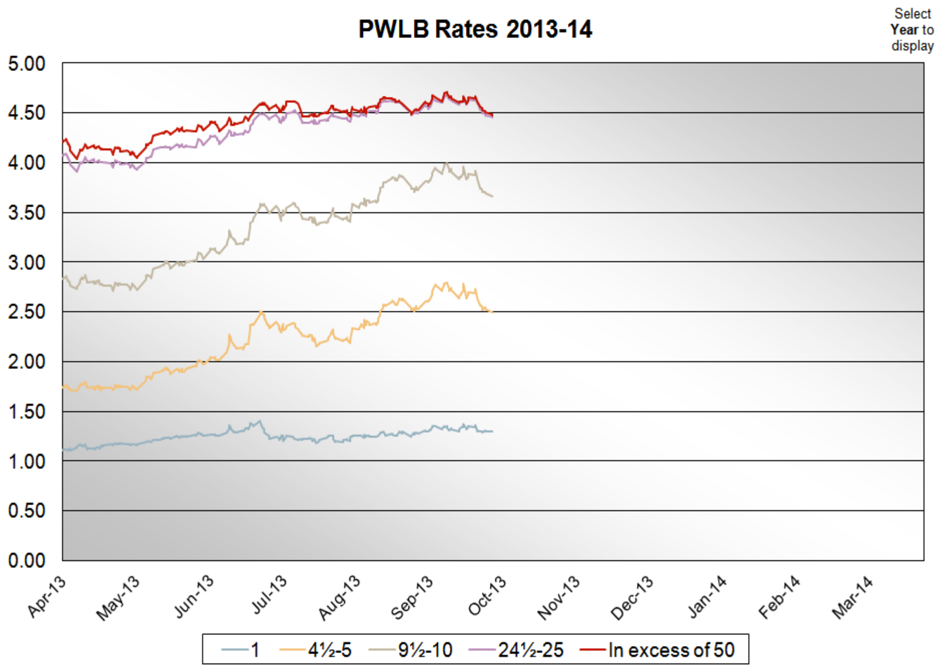
The Commissioner's indicator for capital financing requirement (CFR) for 2013-2014 is £48.685m. The CFR denotes the underlying need to borrow for capital purposes. The Commissioner may borrow from the PWLB or the market (external borrowing) or from internal balances on a temporary basis (internal or under borrowing). The balance of external and internal borrowing is generally driven by market conditions. The following table shows estimated external borrowings of £32.1m, and £16.5m of internal borrowing by the year end. This is a prudent and cost effective approach in the current economic climate. It will require ongoing monitoring as interest rates are predicted to rise in the near future. It is not planned to borrow during this financial year.

	Position @ 01/04/13 £000	Loans taken £000	Loans repaid £000	Position @ 30/09/13 £000
Long Term Borrowing				
PWLB	31,915	0	(3,264)	28,652
LOBO	3,500	0	0	3,500
Estimated PWLB Movements			(635)	(635)
Total External Borrowing	**35,415**	**0**	**(3,264)**	**32,152**
Internal Borrowing				16,533
CFR Approved Indicator				**48,685**
Temporary Borrowing				
Local Authorities	0	2,500	0	2,500
Total Borrowing	**35,415**	**2,500**	**(3,264)**	**51,185**

The borrowing maturity at midyear point is illustrated in the following pie chart.



The graph and table below show the movement in PWLB since March.



As outlined above, the general trend has been an increase in interest rates during the six months, across all maturity bands.

8 Debt Rescheduling

Debt rescheduling opportunities have been limited in the current economic climate and consequent structure of interest rates. However during the first six months of the year, the following debt rescheduling was undertaken using the advice of Capita:

A loan of £2.5 million at a rate of 1.46% was repaid to the PWLB in June 2013 this was at par (ie no discount was receivable or premium payable). It was due to have been repaid 23 December 2015. It has been replaced by the use of short–term borrowings at a lower rate. The first tranche of this has been arranged with Tendring District Council until the end of January 2014 at a rate of 0.29% including brokerage. This has achieved a modest saving of £17k for this period. It is anticipated that it will be possible to arrange the remainder of the borrowing at rates lower than the original loan.

Prudential Indicator Monitoring 2013 - 2014 Appendix 2

	2012-13 Authority Approved Indicator	2012-13 Outturn @ 31 Mar 13	2013-14 Authority Approved Indicator	2013-14 Outturn @ 30 Sept 13
Section 1 - Indicators Based on Expected Outcomes				
Affordability:				
1) Ratio of Financing Costs to Net Revenue Stream	**1.7%**	**1.5%**	**1.8%**	**1.7%**
2) Incremental Impact of Capital Investment Decisions	**£3.46**	**-**	**£2.09**	**-**
3) Actual Capital Expenditure 30 September 2013	**-**	**-**	**-**	**£1.701m**
Estimated Capital Expenditure 31 March 2014		**-**	**-**	**£6.971m**
4) Capital Financing Requirement	**£51.097m**	**£48.016m**	**£50.934m**	**£48.685m**
Section 2 - Indicators Based on Limits				
Affordability:				
1) Actual External Debt 30 September 2013	**-**	**-**	**-**	**£32.152m**
Estimated External Debt 31 March 2014	**-**	**-**	**-**	**£31.516m**
2) Authorised Limit for External Debt	**£65.000m**	**-**	**£60.000m**	**-**
3) Operational Boundary for External Debt	**£55.000m**	**-**	**£50.000m**	**-**
Prudence:				
1) Net Borrowing Requirement & CFR	**£51.097m**	**£50.151m**	**£50.934m**	**£48.685m**