Joint Audit Committee

Warwickshire
Police and Crime Commissioners
Treasury Management Outturn Report 2019/20

Recommendation

The Committee is asked to consider and comment on the Treasury Management Outturn Report for 2019/20 before its final consideration by the Warwickshire Police and Crime Commissioner.

1. Introduction

1.1 Warwickshire Police and Crime Commissioner fully complies with the requirements of The Chartered Institute of Public Finance and Accountancy's (CIPFA's) Code of Practice (COP) on Treasury Management 2011. The primary requirements of the Code are the:

- creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Police and Crime Commissioner's treasury management activities and is informed by the Medium Term Capital Programme.

- creation and maintenance of Treasury Management Practices which set out the manner in which the Police and Crime Commissioner will seek to achieve those policies and objectives;

- receipt by the Police and Crime Commissioner of an annual treasury management strategy report for the year ahead, a midyear review report (as a minimum) and an annual review report of the previous year;

- delegation by the Police and Crime Commissioner of responsibilities for implementing and monitoring treasury management policies and practices, and for the execution and administration of treasury management decisions.

- delegation by the Police and Crime Commissioner of the role of scrutiny of treasury management strategy and policies to a specific named body. In this respect the Police and Crime Commissioner has chosen to delegate this responsibility to the Joint Audit Committee

1.2 Therefore, under the CIPFA Code, the Police and Crime Commissioner is required to receive a report on the outturn of the annual treasury management activity.

1.3 Treasury management in the context of this report is defined as:

"The management of the Police and Crime Commissioner's 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." *(CIPFA Code of Practice)*.

1.4 The Police and Crime Commissioner is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. Part of the treasury management operation is to ensure that this cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in low risk counterparties or instruments commensurate with a low risk appetite, providing security of capital and sufficient liquidity initially before considering investment return.

1.5 The second main function of the treasury management service is the funding of the Police and Crime Commissioner's capital plans. These capital plans provide a guide to the borrowing need of the Police and Crime Commissioner, essentially the longer term cash flow planning to ensure that the Police and Crime Commissioner can meet their capital spending obligations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses. On occasions, debt previously drawn may be restructured to meet the Police and Crime Commissioner's
risk or cost objectives.

1.6 The Police and Crime Commissioner approved a Treasury Management Strategy for 2019/20 in April 2019.

2 Arlingclose have provided the following technical overview on the external context which includes commentary on the economic background, financial markets and credit backgrounds/worthiness for 2019/20. This is a high level overview but should be considered in the light of the treasury management outturn for 2019/20 for Warwickshire.

2.1 Economic background

The UK's progress negotiating its exit from the European Union, together with its future trading arrangements, will continue to be a major influence on the Authority's treasury management strategy for 2020/21. More immediately, the effect of the coronavirus epidemic has depressed economic activity in some countries, particularly China, and is likely to have damaging repercussions for the global economy.

Since first appearing in China in December 2019, the coronavirus has now spread to around 40 countries and caused sharp falls in financial markets as part of a flight to quality into sovereign debt and other perceived ‘safe’ assets. The longer-term impact of the virus on global growth remains uncertain at the moment but as the number of cases and affected countries grows, the impact increases in severity, particularly given the importance of China in global trade. The Federal Reserve cut the Fed Funds policy rate by 0.50% to 1.0 – 1.25%, in order to restore investor confidence and cushion the impact of the virus on activity. Other central banks have followed suit, but this has not stopped a severe reaction in financial markets as investors project a sharp slowdown in global growth.

The UK economy flatlined in Q4 2019 as the political uncertainties surrounding the General Election and Brexit weighed on business and household sentiment. UK GDP growth was flat in the fourth quarter of 2019, according to the initial estimate from the Office for National Statistics, down from an upwardly revised 0.5% in Q3. A recovery in various economic indicators in Q1 2020 suggested the resumption of confidence following the Election result , but expectations of a reduction in Bank Rate are high due to the impact of coronavirus.

Credit outlook: Credit Default Swap spreads have remained broadly flat since the start of 2020 and trading in a slightly tighter range compared to the last calendar quarter of 2019. Spreads have risen due to the onset of coronavirus, but remain low historically.

There were only a few credit updates over the period. Standard & Poor’s revised the outlook on Clydesdale Bank to positive (and affirmed the long-term and short-term ratings) to reflect its view that as part of the Virgin Money group it has made good progress increasing its capital buffer and bail-in eligible liabilities. Moody’s upgraded the long-term ratings of Barclays Bank Plc (non-ringfenced) to A1 and changed the outlook to stable, reflecting an improved operating performance and profitability prospects of the parent, Barclays Plc, which itself was updated to Baa2.

Interest rate outlook: The global economic outlook has rapidly deteriorated with the escalation and spread of coronavirus (COVID-19) to all regions and concerns over its scale and longevity. The economic shock is affecting both supply and demand sides of economies through disruption to trade; containment efforts by governments, corporates and individuals and the damage to sentiment could halve global growth from 2.9% to 1.5% in 2020 (OECD), with a worse-case scenario of a sharper contraction and global recession.

Central banks have already responded in the US, Canada and Australia with interest rate cuts. Outgoing Bank of England Governor has commented the Bank's response will be "powerful and timely" and Arlingclose expects the MPC to deliver two 0.25% reductions in quick succession, the first imminently at an emergency meeting this month.

The government will outline its public spending intentions in the March Budget and undertake substantial fiscal loosening in 2020/21. The Chancellor is now also expected to announce a package of measures to ease COVID-19's pressure on the health service, consumers and businesses. Nevertheless, activity will also hinge on COVID-19's global economic damage and outcome.

Chinese activity remains impaired despite a slowdown in cases. As one of the main drivers of global economic growth and its integral position in many global supply chains, a persistent downturn in its economy is having a global spill-over and wide-ranging ramifications. The UK economy is likely to face issues with supply, due to the global impact on supply chains, and demand, as individuals travel less frequently for both work and leisure. Economic growth will therefore be weak for H1 2020. Prior to the virus, the more stable political environment had prompted a partial return in business and household confidence, and a bounce in economic activity and inflation. Whether this can be maintained or at least returned to during this year depends on the extent and duration of the virus impact.

Economic background:

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

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

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

Then coronavirus swiftly changed everything. COVID-19, which had first appeared in China in December 2019, started spreading across the globe causing plummeting sentiment and falls in financial markets not seen since the Global Financial Crisis as part of a flight to quality into sovereign debt and other perceived ‘safe’ assets.

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

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

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

Financial markets:

Financial markets sold off sharply as the impact from the coronavirus worsened. After starting positively in 2020, the FTSE 100 fell over 30% at its worst point with stock markets in other countries seeing similar huge falls. In March sterling touch its lowest level against the dollar since 1985. The measures implemented by central banks and governments helped restore some confidence and financial markets have rebounded in recent weeks but remain extremely volatile. The flight to quality caused gilts yields to fall substantially. The 5-year benchmark falling from 0.75% in April 2019 to 0.26% on 31st March. The 10-year benchmark yield fell from 1% to 0.4%, the 20-year benchmark yield from 1.47% to 0.76% over the same period. 1-month, 3-month and 12-month bid rates averaged 0.61%, 0.72% and 0.88% respectively over the period.

Since the start of the calendar 2020, the yield on 2-year US treasuries had fallen from 1.573% to 0.20% and from 1.877% to 0.61% for 10-year treasuries. German bund yields remain negative.

Credit review:

In Q4 2019 Fitch affirmed the UK's AA sovereign rating, removed it from Rating Watch Negative (RWN) and assigned a negative outlook. Fitch then affirmed UK banks' long-term ratings, removed the RWN and assigned a stable outlook. Standard & Poor's also affirmed the UK sovereign AA rating and revised the outlook to stable from negative. The Bank of England announced its latest stress tests results for the main seven UK banking groups. All seven passed on both a common equity Tier 1 (CET1) ratio and a leverage ratio basis. Under the test scenario the banks' aggregate level of CET1 capital would remain twice their level before the 2008 financial crisis.

After remaining flat in January and February and between a range of 30-55bps, Credit Default Swap spreads rose sharply in March as the potential impact of the coronavirus on bank balance sheets gave cause for concern. Spreads declined in late March and through to mid-April but remain above their initial 2020 levels. NatWest Markets Plc (non-ringfenced) remains the highest at 128bps and National Westminster Bank Plc (ringfenced) still the lowest at 56bps. The other main UK banks are between 65bps and 123bps, with the latter being the thinly traded and volatile Santander UK CDS.

While the UK and Non-UK banks on the Arlingclose counterparty list remain in a strong and well-capitalised position, the duration advice on all these banks was cut to 35 days in mid-March.

Fitch downgraded the UK sovereign rating to AA- in March which was followed by a number of actions on UK and Non-UK banks. This included revising the outlook on all banks on the counterparty list to negative, with the exception of Barclays Bank, Rabobank, Handelsbanken and Nordea Bank which were placed on Rating Watch Negative, as well as cutting Close Brothers long-term rating to A-. Having revised their outlooks to negative, Fitch upgraded the long-term ratings on Canadian and German banks but downgraded the long-term ratings for Australian banks. HSBC Bank and HSBC UK Bank, however, had their long-term ratings increased by Fitch to AA-.

3 The Police and Crime Commissioner Current Treasury Position

3.1 The Police and Crime Commissioner raises long-term borrowing to fund capital expenditure, i.e., expenditure on land, buildings and equipment. The Police and Crime Commissioner did not take out any new borrowing in 2019/20. As at 31st March 2020, the Commissioner has a total of £12.135m of long-term borrowing.

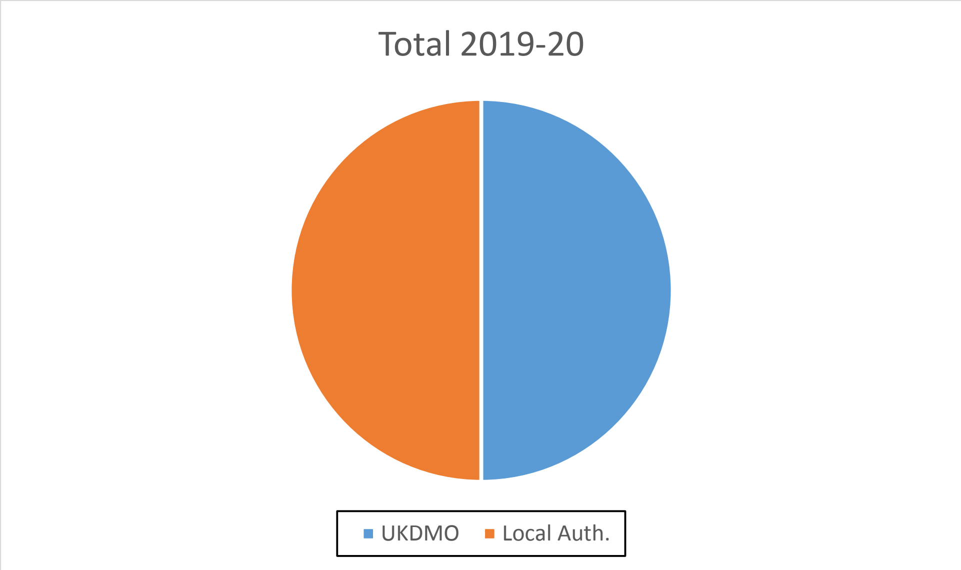
3.2 Alongside any borrowing for capital purposes, the Police and Crime Commissioner also has an investment portfolio. This consists of the Police and Crime Commissioner's reserves and short-term cash flows. This cash was invested in-house in 2019/20.

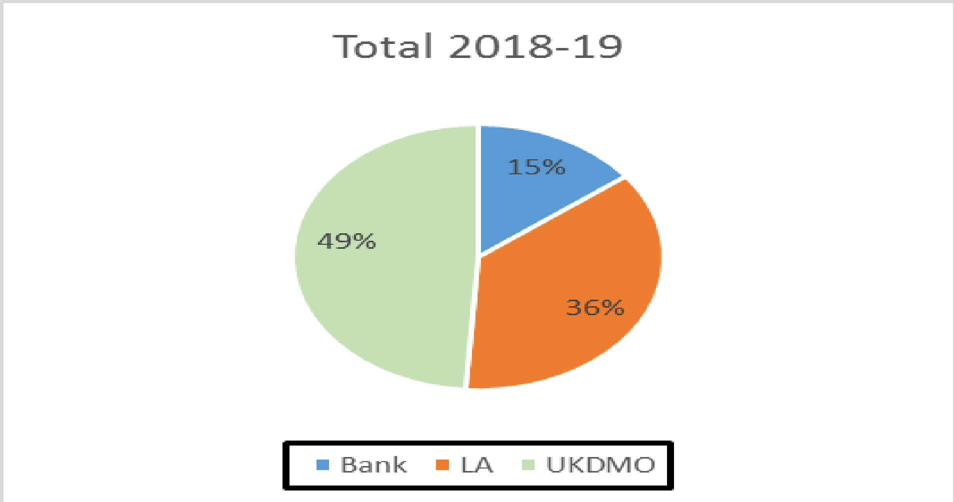
3.3 As at 31 March 2019, the Police and Crime Commissioner for Warwickshire had £13.7m of cash investments and this has decreased to £4m by 31 March 2020, due to holding more cash during the COVID19 pandemic. Table 1.1 shows the Police and Crime Commissioner's debt and investment position at the beginning and the end of the year was as follows:

Table 1: Summary of Treasury Position for Warwickshire at 31 March 20

	Principal at 31.03.19	Rate/ Return For 18/19	Principal at 31.03.20	Rate/ Return for 19/20
A: Fixed Rate Funding	£m	%	£m	%
Public Works Loans Board Debt	13.5	5.02	12.135m	5.02
Total Debt	**13.5**	**5.02**	**12.135m**	**5.02**
B: Investments				
In House	13.7	0.51	4.0m	0.60
Total Investments	**13.7**	**0.51**	**4.0**	**0.6**

The lending breakdown on the following two charts indicates the movement over the period with different providers. Only very slight % movements have occurred during the year.





4 Treasury Management Strategy for 2019/20

4.1 The Police and Crime Commissioner approved the Treasury Management Strategy for 2019/20 in April 2019 based on information from his financial advisors and the expert advice of Arlingclose. The strategy was amended slightly in March 2020 based on the advice from Arlingclose as the coronavirus pandemic began to hit the country and brought with it increased uncertainty in the financial markets. On each occasion, the Joint Audit and Standards Committee reviewed the proposals and the approved strategy is available on the PCC website for information.

5 Borrowing Outturn for 2019/20

5.1 Due to the slippage in the capital programme, the Police and Crime Commissioner did not take any PWLB borrowing in 2019/20. The £3.0m of capital spend was funded mainly from internal borrowing (Reserves) Specific Grants £0.175m and capital grant (£0.4m). Borrowing costs for

Warwickshire were £0.600m compared to a budget of £0.708m, which allowed for additional borrowing. The 2020/21 budget was increased to reflect possible external borrowing that may be required in that year and this is and will be reflected in the appropriate budget and outturn reports.

6 Compliance with Treasury Limits and Prudential Indicators

6.1 During the financial year the Police and Crime Commissioner operated within the treasury limits and Prudential Indicators set out in the Police and Crime Commissioner's Treasury Policy Statement and Treasury Management Strategy.

6.2 Full details of the 'Prudential indicators' set for 2019/20 and the results for the year are shown in **Appendix A.**

7 Investment Rates 2019/20

7.1 The Bank of England Base Rate decreased the rate to 0.25% on 11th March 2020 and again to 0.1% on 19th March 2020. There have been no further decreases since then.

8 Investment Outturn for 2019/20

8.1 The Police and Crime Commissioner's investment policy was governed by MHCLG guidance, which was been implemented in the annual investment strategy approved by the Police and Crime Commissioner in April 19. This policy sets out the approach for choosing investment counterparties, and is based on credit ratings provided by the three main credit rating agencies supplemented by additional market data (such as rating outlooks, credit default swaps, bank share prices etc).

8.2 The Police and Crime Commissioner manages short-term cash balances in-house and investments with the institutions listed in the Police and Crime Commissioner's approved lending list. In 2019/20 the Police and Crime Commissioner has invested for a range of different periods from overnight to one year, dependent on cash flow, its interest rate view and the interest rates on offer. Table 3 summarises the investment performance for 2019/20

.

Table 3: Investment Outturn 2019/20

	Average balance of Investments £m	Rate of Return %	Benchmark Return %
Internally Managed - Warwickshire	12.4	0.60	0.40

8.3 Warwickshire achieved investment income of £95k in 2019/20 compared to a budget of £20k. This additional income has helped support the revenue budget/outturn.

8.4 No institutions in which investments were made had any difficulty in repaying investments and interest in full during the year.

9 Debt Rescheduling for 2019/20

9.1 No debt rescheduling was undertaken in 2019/20

10 Conclusion

10.1 Against a backdrop of uncertainty on the national and international stage, which was heightened to almost unprecedented levels in March as the Coronavirus pandemic took hold, Warwickshire has achieved sound returns from its treasury management activity and has operated within the terms its approved Treasury Management strategy for 2019/20.

10.0 Approved Limits

Approved Limits for Warwickshire

During 2019/20 there was 1 breach of the limits set within the Treasury Management strategy this being with Lloyds Bank, with more than £5m being held overnight - this was corrected within 24 hours.

Approved Counterparty Limits for Warwickshire

During 2019/20 there were no breaches of the approved counterparty list or limits set within the Treasury Management strategy

11.0 Investment Limits

The investment limits for individual organisations or groups of organisations are shown below.

	Warwickshire Cash Limit
Any single organisation, except the UK Central Government	£3m
UK Central Government	Unlimited
Any group of organisations under the same ownership	£3m per group
Registered Providers (Housing Associations)	£6m
Unsecured Investments with Building Societies	£6m
Money Market Funds	£9m

All investments for Warwickshire were made within the limits set by the Treasury Management Strategy. There were no breaches reported during 2019/20.

12.0 Treasury Management Indicators

By 2019/20 the Commissioner had arrangements in place to measure and manage exposure to treasury management risks by the use of Treasury Management indicators governing upper limits for fixed and variable rate exposure

Security

The Commissioners measure of their exposure to credit risk by monitoring the value weighted average credit rating/credit score of their investment portfolios. These rating levels are shown in the table below.

	Target
Portfolio average credit rating for Warwickshire	A+

	Achieved
Portfolio average credit rating for Warwickshire	AA

Liquidity

By 2019/20 the Commissioner measured and managed exposure to treasury management risks using Treasury Management indicators governing upper limits for fixed and variable rate exposure. The details are shown below:

	Target
Total Cash Available for 3 months for Warwickshire	£21.7m

	Achieved
Total Cash Available for 3 months for Warwickshire	>£29.8m

Principal Sums Invested for Periods Longer than 364 days

The purpose of this indicator was to control the Commissioners' exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the long-term principal sum invested to final maturities beyond the period end were:-

	Target
Limit on principal invested beyond the year end for Warwickshire	£5m

	Achieved
Limit on principal invested beyond the year end for Warwickshire	£5m

Sara Ansell
Treasurer

Appendix A

PRUDENTIAL INDICATORS – WARWICKSHIRE

1. AFFORDABILITY PRUDENTIAL INDICATORS	2019/2020 Estimate	2019/2020 Actual	Achieved
	£'000	**£'000**	
Capital Expenditure	7,043	3,009	
	%	**%**	
Ratio of financing costs to net revenue stream	1.60	1.53	Yes
	£'000	**£'000**	
In Year borrowing requirement			
- in year borrowing requirement	6,552	0	Yes
	£'000	**£'000**	
In year Capital Financing Requirement	5,052	1,050	Yes
	£'000	**£'000**	
Capital Financing Requirement 31 March 2019	28,993	25,029	Yes
	£	**£**	
Affordable Borrowing Limit			
Increase per council tax payer	£0.59	£0.71	Yes
2. TREASURY MANAGEMENT PRUDENTIAL INDICATORS	**2018/2019 Estimate**	**2018/2019 Actual**	**Achieved**
Authorised limit for external debt	**£'000**	**£'000**	
- Borrowing	45,000	12,135	Yes
Operational boundary for external debt	**£'000**	**£'000**	
- Borrowing	35,000	12,135	Yes
Upper limit for fixed rate interest exposure			
- net principal re fixed rate borrowing / investments	£40m	£12.5m	Yes
Upper limit for variable rate exposure			
- net principal re variable rate borrowing / investments	£5m	£0m	Yes

There was no new fixed rate borrowing in 2019/20

.