Agenda item:17

Warwickshire Joint Audit and Standards Committee Report Summary

Meeting Date:	**19th January 2022**
Subject:	**Treasury Management outturn report 2020-21**
Contact details:	**Wendy Knox**

Purpose of the Report:

To inform Members of the Committee of the 2020-21 outturn position on the treasury management activities of Warwickshire Police in accordance with the CIPFA Code of Treasury Management.

The report outlines the impact of the economic outlook and its implications on the treasury management portfolio and activity in 2020-21. The in-house Treasury team, with the assistance of our Treasury Management advisors - Arlingclose, will continue to monitor and manage the debt and investment portfolio for Warwickshire and future update reports will be brought to the Joint Audit and Standards Committee for consideration and comment.

Recommendation:

The Committee is asked to consider and comment on the Treasury Management Outturn Report for 2020/21 before its final consideration by the Warwickshire Police and Crime Commissioner.

Background:

Warwickshire Police adopts the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice* (the CIPFA Code) which requires the Authority to approve treasury management semi-annual and annual reports.

The Authority's treasury management strategy for 2020/21 was approved by the Police & Crime Commissioner following scrutiny at a Joint Audit Standards Committee (JASC) meeting, in March 2020, via a formal decision notice, published on the OPCC website. The PCC through the delegations to the force has borrowed and invested moderate sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk remains central to the PCC's treasury management strategy.

Treasury risk management by the PCC is conducted within the framework of the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2017 Edition (the CIPFA Code) which requires the Authority to approve a treasury management strategy before the start of each financial year and, as a minimum, a semi-annual and annual treasury outturn report. This report fulfils the PCC's legal obligation under the Local Government Act 2003 to have regard to the CIPFA Code.

The 2017 Prudential Code includes a requirement for PCC's and local authorities to provide a Capital Strategy, a summary document approved by The Police & Crime Commissioner covering capital expenditure and financing, treasury management and non-treasury investments. The PCC's Capital Strategy, complying with CIPFA's requirement, was also approved by the Commissioner in March 2020, and is also published on the OPCC website.

Executive summary:

This report has been compiled by the force finance team, with assistance from our expert treasury management advisors, Arlingclose. This report also covers a technical overview on the external context which includes commentary on the economic background, financial markets and credit backgrounds/worthiness for 2020/21. This is a high level overview but should be considered in the light of the treasury management outturn for 2020/21 for Warwickshire.

1 Economic background

The coronavirus pandemic dominated 2020/21, leading to almost the entire planet being in some form of lockdown during the year. The start of the financial year saw many central banks cutting interest rates as lockdowns caused economic activity to grind to a halt. The Bank of England cut Bank Rate to 0.1% and the UK government provided a range of fiscal stimulus measures, the size of which has not been seen in peacetime.

Some good news came in December 2020 as two COVID-19 vaccines were given approval by the UK Medicines and Healthcare products Regulatory Agency (MHRA). The UK vaccine rollout started in earnest; over 31 million people had received their first dose by 31st March.

A Brexit trade deal was agreed with only days to spare before the 11pm 31st December 2020 deadline having been agreed with the European Union on Christmas Eve.

The Bank of England (BoE) held Bank Rate at 0.1% throughout the year but extended its Quantitative Easing programme by £150 billion to £895 billion at its November 2020 meeting. In its March 2021 interest rate announcement, the BoE noted that while GDP would remain low in the near-term due to COVID-19 lockdown restrictions, the easing of these measures means growth is expected to recover strongly later in the year. Inflation is forecast to increase in the near-term and while the economic outlook has improved there are downside risks to the forecast, including from unemployment which is still predicted to rise when the furlough scheme is eventually withdrawn.

Government initiatives supported the economy and the Chancellor announced in the 2021 Budget a further extension to the furlough (Coronavirus Job Retention) scheme until September 2021. Access to support grants was also widened, enabling more self-employed people to be eligible for government help. Since March 2020, the government schemes have help protect more than 11 million jobs.

Despite the furlough scheme, unemployment still rose. Labour market data showed that in the three months to January 2021 the unemployment rate was 5.0%, in contrast to 3.9% recorded for the same period 12 months ago. Wages rose 4.8% for total pay in nominal terms (4.2% for regular pay) and was up 3.9% in real terms (3.4% for regular pay). Unemployment is still expected to increase once the various government job support schemes come to an end.

Inflation has remained low over the 12 month period. Latest figures showed the annual headline rate of UK Consumer Price Inflation (CPI) fell to 0.4% year/year in February, below expectations (0.8%) and still well below the Bank of England's 2% target. The ONS' preferred measure of CPIH which includes owner-occupied housing was 0.7% year/year (1.0% expected).

After contracting sharply in Q2 (Apr-Jun) 2020 by 19.8% q/q, growth in Q3 and Q4 bounced back by 15.5% and 1.3% respectively. The easing of some lockdown measures in the last quarter of the calendar year enabled construction output to continue, albeit at a much slower pace than the 41.7% rise in the prior quarter. When released, figures for Q1 (Jan-Mar) 2021 are expected to show a decline given the national lockdown.

After collapsing at an annualised rate of 31.4% in Q2, the US economy rebounded by 33.4% in Q3 and then a further 4.1% in Q4. The US recovery has been fuelled by three major pandemic relief stimulus packages totalling over $5 trillion. The Federal Reserve cut its main interest rate to between 0% and 0.25% in March 2020 in response to the pandemic and it has remained at the same level since. Joe Biden became the 46th US president after defeating Donald Trump.

The European Central Bank maintained its base rate at 0% and deposit rate at -0.5% but in December 2020 increased the size of its asset purchase scheme to €1.85 trillion and extended it until March 2022.

Financial markets: Monetary and fiscal stimulus helped provide support for equity markets which rose over the period, with the Dow Jones beating its pre-crisis peak on the back of outperformance by a small number of technology stocks. The FTSE indices performed reasonably well during the period April to November, before being buoyed in December by both the vaccine approval and Brexit deal, which helped give a boost to both the more internationally focused FTSE 100 and the more UK-focused FTSE 250, however they remain lower than their pre-pandemic levels.

Ultra-low interest rates prevailed throughout most of the period, with yields generally falling between April and December 2020. From early in 2021 the improved economic outlook due to the new various stimulus packages (particularly in the US), together with the approval and successful rollout of vaccines, caused government bonds to sell off sharply on the back of expected higher inflation and increased uncertainty, pushing yields higher more quickly than had been anticipated.

The 5-year UK benchmark gilt yield began the financial year at 0.18% before declining to -0.03% at the end of 2020 and then rising strongly to 0.39% by the end of the financial year. Over the same period the 10-year gilt yield fell from 0.31% to 0.19% before rising to 0.84%. The 20-year declined slightly from 0.70% to 0.68% before increasing to 1.36%.

1-month, 3-month and 12-month SONIA bid rates averaged 0.01%, 0.10% and 0.23% respectively over the financial year.

The yield on 2-year US treasuries was 0.16% at the end of the period, up from 0.12% at the beginning of January but down from 0.21% at the start of the financial year. For 10-year treasuries the end of period yield was 1.75%, up from both the beginning of 2021 (0.91%) and the start of the financial year (0.58%).

German bund yields continue to remain negative across most maturities.

Credit review: After spiking in March 2020, credit default swap spreads declined over the remaining period of the year to broadly pre-pandemic levels. The gap in spreads between UK ringfenced and non-ringfenced entities remained, albeit Santander UK is still an outlier compared to the other ringfenced/retail banks. At the end of the period Santander UK was trading the highest at 57bps and Standard Chartered the lowest at 32bps. The other ringfenced banks were trading around 33 and 34bps while Nationwide Building Society was 43bps.

Subsequent credit developments include Moody's downgrading the UK sovereign rating to Aa3 with a stable outlook which then impacted a number of other UK institutions, banks and local government. In the last quarter of the financial year S&P upgraded Clydesdale Bank to A- and revised Barclay's outlook to stable (from negative) while Moody's downgraded HSBC's Baseline Credit Assessment to baa3 whilst affirming the long-term rating at A1.

The vaccine approval and subsequent rollout programme are both credit positive for the financial services sector in general, but there remains much uncertainty around the extent of the losses banks and building societies will suffer due to the economic slowdown which has resulted due to pandemic-related lockdowns and restrictions. The institutions and durations on the Authority's counterparty list recommended by treasury management advisors Arlingclose remain under constant review, but at the end of the period no changes had been made to the names on the list or the recommended maximum duration of 35 days.

2 The Police and Crime Commissioner Current Treasury Position

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 2020/21. As at 31st March 2021, the Commissioner has a total of £11.152m of long-term borrowing.

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 2020/21.

As at 31 March 2020, the Police and Crime Commissioner for Warwickshire had £4m of cash investments and this has decreased to £1.5m by 31 March 2021, 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 2021

	Principal at 31.03.20	Rate/ Return For 19/20	Principal at 31.03.21	Rate/ Return for 20/21
A: Fixed Rate Funding	£m	%	£m	%
Public Works Loans Board Debt	12.135	5.02	11.152m	5.02
Total Debt	**12.135**	**5.02**	**11.152m**	**5.02**
B: Investments				
In House	4.0	0.60	1.5m	0.10
Total Investments	**4.0**	**0.60**	**1.5**	**0.1**

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.

3 Treasury Management Strategy for 2020/21

The Police and Crime Commissioner approved the Treasury Management Strategy for 2020/21 in March 2020 based on information from his financial advisors and the expert advice of Arlingclose. The Joint Audit and Standards Committee reviewed the proposals and the approved strategy is available on the PCC website for information.

4 Borrowing Outturn for 2020/21

Due to the slippage in the capital programme, the Police and Crime Commissioner did not take any PWLB borrowing in 2020/21. The £10.2m of capital spend was funded mainly from internal borrowing (Reserves), specific grants £0.0.32m, capital grant £0.114m, and capital receipts of £0.045m. Borrowing costs for Warwickshire were £0.554m compared to a budget of £0.600m, as no new borrowing was taken out in 2020/21.

5 Compliance with Treasury Limits and Prudential Indicators

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

The only breaches were in amounts of cash held within our main bank account (Lloyds), which were previously set at £5m, but raised to £10m in March 2020, in case we needed access to more cash due to potential police and staff overtime payments, and to support other local government suppliers to maintain their cashflow at this difficult time, by paying invoices when they were on our ledgers rather than when they were due for payment.

There were brief periods where our cash holding exceeded £10m, despite best efforts to make Short Term investments with other local authorities. Many public sector organisations were temporarily 'cash rich' due to various Government grants issued to pay for additional costs due to Coronavirus. Also, at this time the Bank of England interest rates were extremely low and it was not cost effective to make overnight or short term investments with UKDMO for the amount of interest we would receive.

Full details of the Prudential indicators set for 2020/21 and the results for the year are shown in **Appendix A.**

6 Investment Rates 2020/21

The Bank of England Base Rate did not change between 19th March 2020 and 16th December 2021, where it stood at 0.1%. (interest rates increased to 0.25% on 16th December 2021).

7 Investment Outturn for 2020/21

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 20. 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).

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 2020/21 the Police and Crime Commissioner has invested for a range of different periods from overnight to three months, dependent on cash flow, its interest rate view and the interest rates on offer. Table 3 summarises the investment performance for 2020/21

Table 3: Investment Outturn 2020/21

	Average balance of Investments £m	Rate of Return %	Benchmark Return %
Internally Managed - Warwickshire	8.4	0.10	0.40

Warwickshire achieved investment income of £18k in 2020/21 compared to a budget of £20k. Whilst almost on budget, the interest earned was much less due to our decision to hold more cash, the lower interest rates and difficulty in placing funds in investments with other local authorities.

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

8 Debt Rescheduling for 2020/21

No debt rescheduling was undertaken in 2020/21

9 Approved Limits

Approved Limits for Warwickshire

During 2020/21 there were some brief mid-month instances of breaching the cash holding limits set within the Treasury Management strategy due to difficulty in being able to invest funds short term, and the decision to hold on to more cash. Covid19 continued during the whole year, and our capital programme, gave rise to volatile trends in supplier payments, emphasising the need to hold on to more cash.

Approved Counterparty Limits for Warwickshire

During 2020/21 there were no breaches of the approved counterparty list or limits set within the Treasury Management strategy

10 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 2020/21.

11 Treasury Management Indicators

By 2020/21 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 2020/21 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
Maximum Cash Available for 3 months for Warwickshire	£21.7m

	Achieved
Maximum Cash Available for 3 months for Warwickshire	£20.6m

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

12 Conclusion

Against a backdrop of uncertainty on the national and international stage, due to the continuing Coronavirus pandemic, Warwickshire has achieved acceptable returns from its treasury management activity and has operated within the terms its approved Treasury Management strategy for 2020/21.

Appendix A - PRUDENTIAL INDICATORS – WARWICKSHIRE

1. AFFORDABILITY PRUDENTIAL INDICATORS	2020/21 Estimate	2020/21 Actual	Achieved
	£'000	**£'000**	
Capital Expenditure	12,552	10,200	
	%	**%**	
Ratio of financing costs to net revenue stream	1.49	3.11	Yes
In Year borrowing requirement	**£'000**	**£'000**	
- in year borrowing requirement	0	11,142	Yes
	£'000	**£'000**	
In year Capital Financing Requirement	1,072	1,072	Yes
	£'000	**£'000**	
Capital Financing Requirement 31 March 2019	34,049	32,917	Yes
Affordable Borrowing Limit	**£**	**£**	
Increase per council tax payer	£0.05	£0.05	Yes
2. TREASURY MANAGEMENT PRUDENTIAL INDICATORS	**2020/2021 Estimate**	**2020/2021 Actual**	**Achieved**
Authorised limit for external debt	**£'000**	**£'000**	
- Borrowing	45,000	11,152	Yes
Operational boundary for external debt	**£'000**	**£'000**	
- Borrowing	35,000	11,152	Yes
Upper limit for fixed rate interest exposure			
- net principal re fixed rate borrowing / investments	£40m	£11.1m	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 2020/21