west midlands
police and crime
commissioner

AGENDA ITEM 08

JOINT AUDIT COMMITTEE
29 September 2021

2021/22 TREASURY MANAGEMENT UPDATE REPORT

1. PURPOSE OF REPORT

1.1 This report updates members on recent Treasury Management activity, in line with recommended best practice and the revised CIPFA Code of Practice for Treasury Management. The report provides a summary of macroeconomic factors and also an update of the Police and Crime Commissioner's (PCC) position. It is a mid-year report for the 2021-22 financial year.

1.2 It is important to note that financial information contained within this report should not be used by any individual or organisation as a basis for making investment or borrowing decisions. The PCC and their treasury advisers will not accept any liability on behalf of any individual or organisation who seeks to act on the financial information contained within this report.

1.3 This report has been written with support from the PCC's external treasury management advisors, LINK Treasury Services.

2. BACKGROUND

2.1 The PCC operates a balanced budget, which broadly means cash raised during the year will meet its cash expenditure. Part of the treasury management operations ensure this cash flow is adequately planned, with surplus monies being invested in low risk counterparties, providing adequate liquidity initially before considering optimising investment return.

2.2 The second main function of the treasury management service is the funding of the PCC's capital plans. These capital plans provide a guide to the borrowing need of the PCC, essentially the longer term cash flow planning to ensure the PCC can meet its capital spending plan. 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 PCC risk or cost objectives.

2.3 Accordingly, treasury management is defined as:
"The management of the PCC's borrowing, 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."

3. ECONOMIC UPDATE & INTEREST RATE FORECASTS

3.1 The economic update below will influence how interest rates will move which will impact the rate at which the PCC can borrow and invest money.

3.2 At the August 2021 meeting the Monetary Policy Committee (MPC) voted unanimously to leave Bank Rate unchanged at 0.10% and made no changes to its programme of quantitative easing purchases due to finish by the end of this year at a total of £895bn;

3.3 What the MPC did not provide was any indication on when it would start raising Bank Rate. Inflation is currently expected to peak at over 4% during 2021. **The key issue** is whether this is just going to be transitory inflation or whether it will morph into inflation which will exceed the MPC's 2% target <u>on an ongoing basis</u>. In his press conference, Governor Andrew Bailey said, "the challenge of avoiding a steep rise in unemployment has been replaced by that of ensuring a flow of labour into jobs" and that "the Committee will be monitoring closely the incoming evidence regarding developments in the labour market, and particularly unemployment, wider measures of slack, and underlying wage pressures." In summary, it's worried that labour shortages will push up wage growth by more than it expects and that, as a result, CPI inflation will stay above the 2% target for longer. It remains questionable as to whether the million or so workers who left the UK during the pandemic, will come back to the UK and help to relieve wage inflation pressures. It is also unknown as to how trade with the EU will evolve once the pandemic distortions have dissipated now that the UK no longer has tariff free access to EU markets.

3.4 At the current time, the MPC's forecasts are showing inflation close to, but just below, it's 2% target in 2 to 3 years' time. The initial surge in inflation in 2021 and 2022 is due to a combination of base effects, one off energy price increases and a release of pent-up demand, particularly from consumers who have accumulated substantial savings during the pandemic, hitting supply constraints. However, these effects will gradually subside or fall out of the calculation for inflation. The issue for the MPC will, therefore, turn into a question of when the elimination of spare capacity in the economy takes over as being the main driver to push inflation upwards and this could then mean that the MPC will not start tightening policy until 2023. The MPC has set its policy as wanting to see inflation coming in <u>sustainably</u> over 2% to counteract periods when inflation was below 2%. While financial markets have been pricing in a hike in Bank Rate to 0.25% by mid-2022, and to 0.50% by the end of 2022, this may be premature. The first increase to 0.25% is more likely to come later; LINK (The PCC's treasury management advisors) forecast shows the first increase in Q1 of 23/24 and the second to 0.50% in Q4 of 23/24. The second increase would then open the way for the Bank to cease reinvesting maturing bonds sometime during 2024.

<u>Interest rate forecasts</u>

3.5 Link Group, provided the following interest rate forecasts on 10th August 2021:

Forecasts	*Sep-21*	*Dec-21*	*Mar-22*	*Jun-22*	*Sep-22*	*Dec-22*	*Mar-23*	*Jun-23*	*Mar-24*
Bank Rate	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.25	0.50
5 year PWLB	1.20	1.20	1.20	1.30	1.30	1.30	1.40	1.40	1.50
10 year PWLB	1.60	1.60	1.70	1.70	1.80	1.80	1.90	1.90	2.00
25 year PWLB	1.90	2.00	2.10	2.20	2.30	2.30	2.30	2.40	2.50
50 year PWLB	1.70	1.80	1.90	2.00	2.10	2.10	2.10	2.20	2.30

KEY:
Note: PWLB is the Public Works Loans Board which is the main body though which the PCC borrows money against capital requirements. The rates shown in the table are for interest only loans over different loan periods, with the principal repayable as a lump sum at the end of the loan period.

3.6 The coronavirus outbreak has done significant economic damage to the UK and to economies around the world. After the Bank of England took emergency action in March 2020 to cut Bank Rate to 0.10%, it left Bank Rate unchanged at its subsequent meetings, although some forecasters had suggested that a cut into negative territory could have happened prior to more recent months when strong recovery started kicking in. However, the minutes of the Monetary Policy Committee in February 2021 made it clear that commercial banks could not implement negative rates within six months; by that time the economy would be expected to be recovering strongly and so there would be no requirement for negative rates. As shown in the forecast table above, one increase in Bank Rate from 0.10% to 0.25% has now been included in quarter 1 of 2023/24 and another increase to 0.50% in quarter 4 of 23/24, as an indication that the Bank of England will be starting monetary tightening during this year.

3.7 As the interest forecast table for PWLB certainty rates, above shows, there is likely to be an unwinding of the currently depressed levels of PWLB rates and a steady rise over the forecast period, with some degree of uplift due to rising treasury yields in the US. There is likely to be **exceptional volatility and unpredictability in respect of PWLB rates.**

3.8 The forecasts are also predicated on an assumption that there is no break-up of the Eurozone or EU within the forecasting period, despite the major challenges that are looming up, and that there are no major ructions in international relations, especially between the US and China / North Korea and Iran, which have a major impact on international trade and world GDP growth.

<u>The balance of risk to the UK</u>

3.9 The overall balance of risks to economic growth in the UK is now to the upside though there are still residual risks from Covid variants - both domestically and their potential effects worldwide, and from various shortages.

4. ANNUAL INVESTMENT STRATEGY

4.1 The Treasury Management Strategy Statement (TMSS) for 2021/22 was approved by the PCC in March 2021. The PCC's Annual Investment Strategy which is included in the

TMSS outlines the PCC's investment priorities as "Security of Capital, Liquidity and Yield".

4.2 The best possible return on investments will be pursued but only to the extent that this is consistent with the proper levels of security and liquidity. In the current economic climate it is considered appropriate to keep investments short term to cover cash flow needs, but also to seek out value available in periods of up to 12 months with high credit rated financial institutions, using the Link suggested creditworthiness approach which includes daily credit rating updates.

4.3 As shown by the interest rate forecasts in section 4, it is now impossible to earn the level of interest rates commonly seen in previous decades as all short-term money market investment rates have only risen weakly since Bank Rate was cut to 0.10% in March 2020. Given this environment and the fact that Bank Rate may only rise marginally, or not at all, before the second half of 2023, investment returns are expected to remain low.

4.4 Due diligence is undertaken for all investments made including those with Local Authority bodies. A summary of the investments/cash position held at 13/09/2021 is shown below:

	£m
Instant Access	79.3
Money market Funds	30.0
Investments	85.0
Property Fund	5.0
Total	**199.3**

A full list of investments held as at 12 September 2021 is shown in **Appendix 1.** This is high because the PCC received the full year's police pensions top up grant of £83m in July and the monthly police grant from Government of £40m has been received for September. This balance will be utilised between December 2021 and March 2022.

4.5 The average cumulative interest rate achieved on investments made in 2021/22 is currently 0.05% which compares with 0.05% for the SONIA rate (Sterling Overnight Index Average). The overall interest expected on all investments (excluding the property fund) is 0.28%.

4.6 The PCC's budgeted investment return for 2021/22 is £520k. The expected interest receivable for the year including property investments is expected to be in line with the budget.

4.7 MMF's have been utilised by the PCC for the first time in 2021-22. Currently £30m is invested with the CCLA MMF at a rate of 0.025%. This investment has no maturity date and is repayable on demand (without any charges or penalties)

4.8 In the 12 months to 31 March 2021 the £5m investment in the CCLA property fund had delivered a total performance of +3.75% when compared to the benchmark of 2.46% showing out performance 129bps (basis points). However long term performance is in line with the benchmark.

4.9 There have been regular occurrences of the funds in our instant access account with NatWest having breached the amount set out the Treasury management policy, £65m. The primary reason for this is the lack of suitable counterparties where the levels of risk and return are consummate with our risk appetite. The risk of having a significant proportion of funds with any single counterparty is default risk and therefore the PCC will always seek to diversify and not have more than £65m with Natwest. There is some reassurance that NatWest continue to maintain a high credit rating and are partially owned by the UK Government.

5. PRUDENTIAL INDICATORS

5.1 It is a statutory duty for the PCC to determine and keep under review the affordable borrowing limits that were part of the Prudential Indicators agreed in the Treasury Management Strategy Statement approved in March 2021.

5.2 The Prudential Indicators were not breached during the first 5 months of 2021/22, as shown in the table below:

Prudential Indicator	***2021/22 Indicator***	***Actual to 31/08/21***
Capital Financing Requirement (CFR)	£93.6m	£81.2m
Gross Borrowing	£114.5m	£94.5m
Authorised Limit for External Debt	£125m	£94.5m
Operational Boundary for External Debt	£120m	£94.5m
Limit of Fixed Interest Rates based on Net Debt	100%	100%
Limit of Variable Interest Rates based on Net Debt	20%	0%
Maturity Structure of Borrowing Limits	***2021/22 Indicator***	***Actual to 31/08/21***
Under 12 Months	25%	0%
12 Months to 2 Years	25%	3%
2 Years to 5 Years	50%	5%
5 Years to 10 Years	75%	0%
10 Years and Above	100%	92%

5.3 All of the PCC's borrowing to date, has been obtained from the PWLB as shown in **Appendix 2**. All of the borrowing taken out to date has been applied to finance historic capital spend. No additional borrowing has been undertaken so far in 2021/2. It is anticipated that additional borrowing will be required in line with the Estates Strategy but this will be kept under review against the actual capital spend and receipts in year.

5.4 The approved estates programme in 2018 is funded through a mix of financing, including capital receipts and borrowing. The COVID 19 pandemic has resulted in different demands on the estates, this will be taken into consideration as the programme is reviewed, which may in turn affect the borrowing requirements of the PCC. This will be closely monitored and reported at the end of the year.

6. RECCOMENDATIONS

6.1 The Committee is recommended to note the report which complies with the CIPFA Code of Practice for Treasury Management.

Mark Kenyon	Neil Chamberlain
Chief Finance Officer	Director of Commercial Services
Police and Crime Commissioner	West Midlands Police

Appendix 1
INVESTMENTS AND BALANCES AS AT 12/09/21

Maturity	Counterparty	Type	Principal	Rate
24-Sep-21	Coventry Building Society	Bank/Building Society	10,000,000	0.02%
01-Oct-21	National Bank of Kuwait	Bank/Building Society	10,000,000	0.12%
05-Oct-21	National Bank of Kuwait	Bank/Building Society	10,000,000	0.12%
14-Oct-21	Leeds Building Society	Bank/Building Society	10,000,000	0.04%
15-Oct-21	Leeds Building Society	Bank/Building Society	10,000,000	0.04%
15-Oct-21	Leeds Building Society	Bank/Building Society	10,000,000	0.04%
25-Oct-21	National Bank of Kuwait	Bank/Building Society	10,000,000	0.13%
25-Mar-22	Wokingham BC	Local Authority	5,000,000	1.45%
07-Jul-23	Dudley MBC	Local Authority	10,000,000	1.70%
On demand	Money market Fund (MMF's)	MMF	30,000,000	0.03%
5 to 10 years	CCLA Property fund	Property	5,000,000	Variable
On demand	NatWest	Instant Access	79,300,000	
	Total		**199,300,000**	

Appendix 2

TREASURY MANAGEMENT REPORT: AUGUST 2021

1. LONG TERM EXTERNAL BORROWING

Principal	rate	annual int.	maturity
580,000	6.125%	35,525.00	31/03/2023
2,420,000	6.125%	148,225.00	31/03/2023
800,000	6.625%	53,000.00	15/10/2023
2,200,000	6.625%	145,750.00	15/10/2024
2,000,000	6.625%	132,500.00	15/10/2025
15,000,000	3.700%	555,000.00	23/01/2051
5,587,000	4.450%	248,621.50	15/06/2056
8,200,000	4.350%	356,700.00	01/03/2057
5,000,000	4.390%	219,500.00	15/08/2058
2,000,000	4.875%	97,500.00	01/09/2061
10,000,000	2.640%	264,000.00	07/12/2068
10,000,000	2.540%	254,000.00	10/12/2068
5,000,000	2.370%	118,500.00	12/02/2069
10,000,000	2.160%	216,000.00	28/03/2069
15,000,000	1.630%	244,500.00	08/10/2069
93,787,000		**3,089,321.50**	

Average rate of interest payable is 3.3% all of which is at a fixed rate

2. TEMPORARY EXTERNAL BORROWING

There is currently no short term external borrowing