# Police and Crime Commissioner for Hampshire and Hampshire Constabulary

## Joint Audit Committee – 28 June 2021

*Annual Treasury Outturn Report 2020/21*

#### Report of the Chief Finance Officer of the Office of the Police and Crime Commissioner

##### Purpose

* 1. The Office of the Police and Crime Commissioner for Hampshire (OPCC) has adopted the key recommendations of the Chartered Institute of Public Finance and Accountancy’s Treasury Management in the Public Services: Code of Practice (the CIPFA Code), last updated in 2017. The CIPFA Code requires the OPCC to approve a treasury management strategy before the start of the year and a semi-annual and annual treasury outturn report. The purpose of this report is therefore to meet this obligation by providing an update on the performance of the treasury management function during 2020/21.

##### Recommendation

* 1. It is recommended that the Joint Audit Committee considers the report and makes observations as appropriate.

##### Executive Summary

* 1. The report fulfils the OPCC’s legal obligation under the Local Government Act 2003 to have regard to the CIPFA Code and provides an update on the performance of the treasury management function during 2020/21.
	2. The OPCC’s treasury management strategy was most recently updated and approved by the Police and Crime Commissioner (PCC) for Hampshire in March 2021. The OPCC has borrowed and invested 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 are therefore central to the OPCC’s treasury management strategy.
	3. Treasury management in the context of this report is defined as: “The management of the organisation’s 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.”
	4. This annual report sets out the performance of the treasury management function during 2020/21, to include the effects of the decisions taken and the transactions executed in the past year.
	5. Overall responsibility for treasury management remains with the OPCC. No treasury management activity is without risk and the effective identification and management of risk are therefore integral to the OPCC’s treasury management objectives.
	6. All treasury activity has complied with the OPCC’s Treasury Management Strategy and Investment Strategy for 2020/21, and all relevant statute, guidance and accounting standards. In addition, support in undertaking treasury management activities has been provided by the OPCC’s treasury advisers, Arlingclose.
	7. The 2017 Prudential Code includes the requirement to produce and have approved a Capital Strategy, a summary document covering capital expenditure and financing, treasury management and non-treasury investments. The OPCC’s most recent Capital and Investment Strategy, complying with CIPFA’s requirement, was approved by the PCC in February 2021.

##### External Context

* 1. The following sections outline the key economic themes against which investment and borrowing decisions were made in 2020/21.

###### Economic commentary

* 1. The coronavirus pandemic dominated 2020/21, resulting in significant levels of government borrowing and expenditure to support the economy, with the UK also agreeing a Brexit trade deal within the period.
	2. The Bank of England (BoE) held Bank Rate at 0.1% throughout the year and extended its Quantitative Easing programme by £150bn to £895bn in November 2020. The Bank expects Gross Domestic Product (GDP) to remain low in the near-term but believes that the easing of restrictions is likely to lead to a strong recovery in growth later in 2021, with inflation forecast to increase in the near-term. The economic outlook has improved but downside risks remain, such as a further increase in unemployment when the furlough scheme ends.
	3. Inflation remained low during 2020/21, with the annual headline rate of UK Consumer Price Inflation (CPI) rising to 0.7% year-on-year in March 2021, below expectations and below the BoE’s 2% target. Unemployment was higher for the three months to March 2021 than for the same period the previous year, while periods of GDP contractions and growth over the year largely mirrored the tightening and easing of restrictions, creating some significant quarterly swings.

###### Financial markets

* 1. Monetary and fiscal stimulus helped provide support for equity markets which rose over the period. In the UK, the FTSE indices performed reasonably well during the period to November 2020 before being buoyed in December by both the vaccine approval and Brexit deal.
	2. 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.

###### Credit review

* 1. After spiking in March 2020, credit default swap spreads subsequently declined to broadly pre-pandemic levels. Credit default swaps are used as an indicator of credit risk, where higher premiums indicate higher perceived risks.
	2. Moody’s downgraded the UK sovereign rating to Aa3 with a stable outlook during the period and this change had an impact on a number of other UK institutions, banks and local government.
	3. 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 pandemic and the effects of lockdowns and restrictions. This uncertainty means the OPCC’s treasury management advisors, Arlingclose, continue to recommend maximum durations of 35 days for unsecured investments with banks and building societies on their list of recommended counterparties.

##### Local Context

* 1. At 31 March 2021 the OPCC’s underlying need to borrow for capital purposes was £54.7m as measured by the Capital Financing Requirement (CFR), while usable reserves and working capital, which are the underlying resources available for investment, amounted to £97.5m (useable reserves £101.38m less working capital £3.86m). These factors are summarised in Table 1.

|  |  |  |  |
| --- | --- | --- | --- |
| **Table 1: Balance sheet summary** | **31/03/20Balance£m** | **Movement£m** | **31/03/21Balance£m** |
| CFR | 56.25 | (1.58) | 54.67 |
| External borrowing |  |  |  |
| * Public Works Loan Board
 | (30.45) | 0.50 | (29.95) |
| **Internal borrowing** | **25.80** | **(1.08)** | **24.72** |
| Less: Working capital | 3.86 | - | 3.86 |
| Less: Usable reserves | (76.76) | (24.62) | (101.38) |
| **Net investments** | **(47.10)** | **(25.70)** | **(72.80)** |

* 1. The CFR has remained fairly consistent with last year and there has been repayment of £0.50m of Public Works Loan Board loans that have matured and not been replaced, both of which have led to an increase in internal borrowing of £0.53m. Usable reserves have increased by £26.1m due to a number of factors including £13m transferred from revenue budgets for a number of future projects including Estates, ICT and the replacement of airwaves. In addition a total of £9m of underspend against budgets for Hampshire Constabulary, the OPCC and ACRO have been transferred to usable reserves in addition to £2m of Covid grant that was not utilised in year and transferred to the Revenue Grants Unapplied Reserve.
	2. It is likely that new external borrowing will be required in future years to fund capital expenditure commitments, and the CFO will work closely with Hampshire County Council’s Investments and Borrowing team and the treasury advisors Arlingclose to ascertain at what point it would be prudent to take out additional borrowing.
	3. The costs associated with the underlying need to borrow externally to fund planned expenditure are factored into the budget in the form of MRP and interest costs, and provisional numbers have also been built into the MTFS for future years. The capital programme is reviewed annually and capital financing requirements are recalculated as necessary.
	4. The OPCC’s strategy was to maintain borrowing and investments below their underlying levels, referred to as internal borrowing, to reduce risk and keep interest costs low. This has meant that internal funds have been utilised in lieu of taking on external borrowing debt. The treasury management position as at 31 March 2021 and the change during the year are shown in Table 2.

| **Table 2: Treasury management summary** | **31/03/20Balance£m** | **Movement£m** | **31/03/21Balance£m** | **31/03/21Rate%** |
| --- | --- | --- | --- | --- |
| Long-term borrowing | (29.95) | 0.25 | (29.7) | 4.29 |
| Short-term borrowing | (0.50) | 0.25 | (0.25) | 2.65 |
| **Total borrowing** | **(30.45)** | **0.50** | **(29.95)** | **4.28** |
| Long-term investments | 7.50 | 3.5 | 11.00 | 4.20 |
| Short-term investments | 12.51 | 40.99 | 53.50 | 0.19 |
| Cash and cash equivalents | 28.32 | (19.87) | 8.45 | 0.00 |
| **Total investments** | **48.33** | **24.62** | **72.95** | **0.77** |
| **Net treasury management investments** | **17.88** | **25.12** | **43.00** |  |

Note: the figures in Table 2 are taken from the balance sheet in the OPCC’s statement of accounts, but adjusted to exclude operational cash, accrued interest and other accounting adjustments.

* 1. The increase in net investments of £25.12m shown in Table 2 reflects the combination of repayment of Public Works Loan Board (PWLB) borrowing of £0.5m and an increase in investment balances of £24.6m due in part to the setting aside of funding to support future capital investment and also due to an underspend against the Constabulary, OPCC and ACRO budgets during 2020/21. The repayment of borrowing is in line with the OPCC’s policy on internal borrowing. Further details are provided in the Borrowing Activity and Treasury Investments Activity sections of this report.

##### Borrowing Update

* 1. In November 2020 the PWLB published its response to the consultation on ‘Future Lending Terms’. The rate at which local authorities (including police and crime commissioners) could borrow from the PWLB is defined by a margin above gilts; following the response to the consultation the margin above gilts on PWLB loans was reduced from 1.8% to 0.8%, however restrictions were introduced meaning that this rate would only be available to authorities not planning to purchase investment assets primarily for yield. Authorities that are purchasing or intending to purchase investment assets primarily for yield will not be able to access the PWLB except to refinance existing loans or externalise internal borrowing. Acceptable use of PWLB borrowing includes service delivery, housing, regeneration, preventative action, refinancing, and treasury management.
	2. As part of the borrowing process authorities are now required to submit more detailed capital expenditure plans with confirmation of the purpose of capital expenditure from the Section 151 Officer. The PWLB can now also restrict local authorities from borrowing in unusual or large amounts.
	3. The OPCC is not planning to purchase any investment assets primarily for yield and so is able to take advantage of the reduction in the PWLB borrowing rate if required.

##### Borrowing Activity

* 1. At 31 March 2021 the OPCC held £29.95m of loans (a decrease of £0.5m from 31 March 2020) as part of its strategy for funding previous years’ capital programmes. The year-end treasury management borrowing position and year-on-year change are summarised in Table 3.

| **Table 3: Borrowing position** | **31/03/20Balance£m** | **Net movement£m** | **31/03/21Balance£m** | **31/03/21Weighted average rate%** | **31/03/21Weighted average maturity(years)** |
| --- | --- | --- | --- | --- | --- |
| Public Works Loan Board | (30.45) | 0.50 | (29.95) | 4.28 | 13.29 |
| **Total borrowing** | **(30.45)** | **0.50** | **(29.95)** | **4.28** | **13.29** |

Note: the figures in Table 3 are from the balance sheet in the OPCC’s statement of accounts but adjusted to exclude accrued interest.

* 1. The OPCC’s chief objective when considering borrowing has been to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required. The flexibility to renegotiate loans should the OPCC’s long-term plans change is a secondary objective.
	2. Short-term interest rates have remained much lower than long-term rates and the Chief Finance Officer for the OPCC has therefore considered it to be more cost effective in the near term to use internal resources than to use additional borrowing. In line with this strategy £0.5m of PWLB loans were allowed to mature without refinancing.
	3. This borrowing strategy has been monitored with the assistance of Arlingclose and has enabled the OPCC to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk.

##### Treasury Investment Activity

* 1. The OPCC holds invested funds representing income received in advance of expenditure plus balances and reserves held. During the year, the OPCC’s investment balances have ranged between £26.9m and £107.9m due to timing differences between income and expenditure. The year-end investment position and the year-on-year change are shown in Table 4.

| **Table 4: Treasury investment position** | **31/03/2020 Balance****£m** | **Net movement****£m** | **31/03/2021 Balance****£m** | **31/03/21Income return****%** | **31/03/21Weighted average maturity****(years)** |
| --- | --- | --- | --- | --- | --- |
| Short term investments  |  |  |  |  |  |
| * Banks and building societies
 |  |  |  |  |  |
| * + Unsecured
 | 8.05 | 5.73 | 13.78 | 0.07 | 0.04 |
| * Secured
 | 4.00 | - | 4.00 | 0.28 | 0.04 |
| * Money market funds
 | 20.28 | (12.61) | 7.67 | 0.00 | 0.00 |
| * Local authorities
 | 8.50 | 28.00 | 36.50 | 0.22 | 0.18 |
| **Total** | **40.83** | **21.12** | **61.95** | **0.16** | **0.12** |
| Long term investments  |  |  |  |  |  |
| * Local authorities
 | - | 2.00 | 2.00 | 1.60 | 2.04 |
| **Total** | **-** | **2.00** | **2.00** | **1.60** | **2.04** |
| Higher yielding investments |  |  |  |  |  |
| * Pooled funds:
 |  |  |  |  |  |
| * Pooled property\*
 | 4.00 | - | 4.00 | 4.34 | N/A |
| * Pooled equity\*
 | 2.00 | - | 2.00 | 6.09 | N/A |
| * Pooled multi-asset\*
 | 1.50 | 1.50 | 3.00 | 4.51 | N/A |
| **Total** | **7.50** | **1.50** | **9.00** | **4.78** | **N/A** |
| **Total investments** | **48.33** | **24.62** | **72.95** | **0.77** | **0.18** |

\* The rates provided for pooled fund investments are reflective of annualised income returns over the year to 31 March 2021 based on the market value of investments at the start of the year.

Note: the figures in Table 4 are from the balance sheet in the OPCC’s statement of accounts, but adjusted to exclude operational cash, accrued interest and other accounting adjustments.

* 1. The OPCC made a payment of £11.6m on 1 April 2020 to prepay its employer’s LGPS pension contributions for one year. By making this payment in advance the OPCC was able to generate an estimated saving of £0.25m over the year on its pension contributions.
	2. Investment balances have increased for the reasons set out above in paragraph 5.2.The availability of appropriate longer term investments combined with the prudent management of shorter term investment balances during an uncertain economic market meant that the majority of the additional investment balances were held as short term investments at 31 March 2021, with local authorities which do not attract bail-in risk. Looking forward into the forthcoming year, the stable core of these additional balances will be invested for the longer term as appropriate investment opportunities become available.
	3. The CIPFA Code and government guidance both require the OPCC to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The OPCC’s objective when investing money is therefore to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults alongside the risk of receiving unsuitably low investment income. The OPCC’s Treasury Management Strategy Statement (TMSS) sets out how it will manage and mitigate these risks.
	4. The security of investments has been maintained by following the counterparty policy and investment limits within the TMSS, taking advice from Arlingclose on changes in counterparty credit worthiness, and making use of secured investment products that provide collateral. The OPCC should invest in liquid investments to ensure money is available when required to meet its financial obligations, spreading these investments across a number of counterparties to mitigate operational risk.
	5. In delivering investment returns, the OPCC has operated against a backdrop in which the UK Bank Rate was cut to 0.10% in March 2020 in response to the coronavirus pandemic. It has remained at this rate throughout the year, having an impact on rates across the market. Returns had been at or around 0% for liquid investment options such as Money Market Funds (MMFs), bank call accounts and the UK Government’s Debt Management Account Deposit Facility (DMADF) and have not been significantly higher for other short-term options like fixed duration loans to local authorities and bank notice accounts. Investment income has therefore largely come from investments arranged at fixed rates of interest prior to the pandemic and through the OPCC’s investments in pooled funds.
	6. The OPCC benchmarks the performance of its internally managed investments against that of other Arlingclose clients. Internally managed investments include all investments except externally managed pooled funds but do include MMFs. The performance of these investments against relevant measures of security, liquidity and yield are shown in Table 5, providing data for the quarter ended 31 March 2021 and at the same date in 2020 for comparison.

| **Table 5: Investment benchmarking (excluding pooled funds)** | **Credit rating** | **Bail-in exposure** | **Weighted average maturity(days)** | **Rate of return** |
| --- | --- | --- | --- | --- |
| 31.03.2020 | AA- | 69% | 24 | 0.58% |
| 31.03.2021 | AA- | 33% | 66 | 0.22% |
| Police & Fire Authorities | A+ | 70% | 26 | 0.09% |
| All LAs | A+ | 63% | 14 | 0.15% |

* 1. Table 5 shows the average credit rating of the portfolio has remained consistent at 31 March 2021 in comparison to the previous year. Bail-in exposure was lower than at the same time in 2020, as the OPCC held a greater investment balance with local authorities, who are not subject to bail-in risk, while the weighted average maturity of investments was higher due to the OPCC holding more local authority investments and less invested in more liquid investment options. The average rate of return (0.22%) was lower than at 31 March 2020, but the benefit of higher rates for fixed investments made prior to the pandemic helped to offset returns at or close to 0% for many investments across the market. The OPCC compared favourably with all other local authorities (including police and crime commissioners) included in the benchmarking exercise across all metrics.

###### Externally managed pooled funds

* 1. In order to minimise the risk of receiving unsuitably low investment income, the OPCC has continued to invest a proportion of steady core balances in externally managed pooled funds as part of its higher yielding strategy.
	2. The CIPFA Code requires the OPCC to invest its funds prudently and to have regard to the security and liquidity of its investments before seeking the highest yield. As a result, the OPCC’s investments targeting higher yields have been made from its most stable balances and with the intention that they will be held for at least the medium term. This means that the initial costs of any investment and any periods of falling capital values can be overcome and mitigates the risk of having to sell an asset for liquidity purposes, helping to ensure the long-term security of the OPCC’s investments.
	3. The OPCC’s investments in pooled funds fell considerably in value when the coronavirus pandemic hit world markets but have since recovered well. This recovery means these investments are now worth marginally more in aggregate than the initial sums invested, as shown in Table 6, demonstrating the importance of taking a longer term approach and being able to ride out periods of market volatility, ensuring the OPCC is not a forced seller at the bottom of the market.

| **Table 6 – Higher yielding investments – market value performance** | **Amount invested** | **Market value at 31/03/21** | **Gain/(fall) in capital value**  |
| --- | --- | --- | --- |
| **Since purchase** | **2020/21** |
|  | **£m** | **£m** | **£m** | **£m** |
| Pooled property funds | 4.0 | 3.9 | (0.1) | 0.0 |
| Pooled equity funds | 2.0 | 2.2 | 0.2 | 0.6 |
| Pooled multi-asset funds | 3.0 | 3.1 | 0.1 | 0.3 |
| **Total pooled funds** | **9.0** | **9.2** | **0.2** | **2.4** |

* 1. The OPCC’s investments in pooled funds target long-term price stability and regular revenue income and bring significant benefits to the revenue budget. As shown in Table 7 the annualised income returns have averaged 4.46% pa (per annum), contributing to a total return of 18.71%.

| **Table 7 – Higher yielding investments – income and total returns since purchase** | **Annualised income return****%** | **Total return** **%** |
| --- | --- | --- |
| Pooled property funds | 4.28 | 19.39 |
| Pooled equity funds | 4.90 | 33.28 |
| Pooled multi-asset funds | 4.27 | 8.09 |
| **Total pooled funds** | **4.46** | **18.71** |

* 1. Actual income returns from pooled fund investments originally was £0.37m, which was about 37% higher than in 2019/20; the increase on last year’s income is a result of making additional investments into the pooled funds over the last two years, including an additional £1.5m into pooled multi-asset funds during 2020/21. This level of income is compared with the 25% to 30% reduction that could reasonably have been anticipated given the pandemic’s impact on property rental income, company dividends and bond yields. The OPCC’s pooled fund investments continue to deliver income returns far in excess of what could be generated from cash investments and accounted for 70% of the OPCC’s total income from its treasury investments, despite making up only 10% of the average investment balance.
	2. The cumulative total return from the OPCC’s investments in pooled equity, property and multi-asset funds since purchase is shown in the following graph. This highlights that the OPCC has benefited from strong and steady income returns over time and the way that capital values have recovered since March 2020.



* 1. The IFRS 9 accounting standard that was introduced in 2018/19 means that annual movements in the capital values of investments need to be reflected in the revenue account on an annual basis, although a five year statutory override was put in place for local authorities (including police and crime commissioners) that exempts them from complying with this requirement.
	2. Pooled fund investments have no defined maturity date but are available for withdrawal after a notice period and their performance and continued suitability in meeting the OPCC’s investment objectives is monitored regularly and discussed with Arlingclose.

##### Financial Implications

* 1. The outturn for debt interest paid in 2020/21 was £1.3m on an average debt portfolio of £30.2m.
	2. The outturn for investment income received in 2020/21 was £531,000, (against a budget of £500,000) on an average investment portfolio of £79.4m, therefore giving an average yield for the year of 0.67%.

##### Non-Treasury Investments

* 1. The definition of investments in CIPFA’s revised Treasury Management Code now covers all the financial assets of the OPCC as well as other non-financial assets which the OPCC holds primarily for financial return. This is replicated in the Ministry for Housing, Communities, and Local Government’s Investment Guidance, in which the definition of investments is further broadened to also include all such assets held partially for financial return.
	2. This could include the direct purchase of land or property and any such loans and investments will be subject to the OPCC’s normal approval processes for revenue and capital expenditure and need not comply with the treasury management strategy. The OPCC does not have any existing non-treasury investments.

##### Compliance Report

* 1. The OPCC confirms compliance of all treasury management activities undertaken during 2020/21 with the CIPFA Code of Practice and the OPCC’s approved Treasury Management Strategy.
	2. Compliance with the authorised limit and operational boundary for external debt, is demonstrated in Table 8.

| **Table 8: Debt limits** | **2020/21Maximum£m** | **31/03/21 Actual£m** | **2020/21Operational Boundary£m** | **2020/21Authorised Limit£m** | **Complied?** |
| --- | --- | --- | --- | --- | --- |
| Borrowing | (31.8) | (30.0) | (71.1) | (86.1) | Yes |
| Other long term liabilities | - | - | (5.0) | (5.0) | Yes |
| **Total debt** | **(31.8)** | **(30.0)** | **(76.1)** | **(91.1)** | Yes |

##### Treasury Management Indicators

* 1. The OPCC measures and manages its exposures to treasury management risks using the following indicators.

###### Interest rate exposures

* 1. The following indicator shows the sensitivity of the OPCC’s current investments and borrowing to a change in interest rates.

| **Table 9: Interest rate risk indicator** | **31/03/21Actual** | **Impact of a +/- 1% interest rate change** |
| --- | --- | --- |
| Sums subject to variable interest rates: |  |  |
| Investment | £71.0m | +/-£0.2m |
| Borrowing | - | - |

* 1. Fixed rate investments and borrowings are those where the rate of interest is fixed for the whole financial year. Instruments that mature during the financial year are classed as variable rate.

###### Maturity structure of borrowing

* 1. This indicator is set to control the OPCC’s exposure to refinancing risk. The upper and lower limits show the maximum and minimum maturity exposure to fixed rate borrowing as agreed in the Treasury Management Strategy Statement.

| **Table 10: Maturity structure of borrowing** | **31/03/21Actual** | **Upper Limit** | **Lower Limit** | **Complied** |
| --- | --- | --- | --- | --- |
| Under 12 months | 1% | 50% | 0% | Yes |
| 12 months and within 24 months | 0% | 50% | 0% | Yes |
| 24 months and within 5 years | 2% | 50% | 0% | Yes |
| 5 years and within 10 years | 0% | 75% | 0% | Yes |
| 10 years and within 20 years | 97% | 100% | 0% | Yes |
| 20 years and above | 0% | 100% | 0% | Yes |

###### Principal sums invested for periods longer than a year

* 1. The purpose of this indicator is to control the OPCC’s 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:

| **Table 11: Price risk indicator** | **2020/21** | **2021/22** | **2022/23** |
| --- | --- | --- | --- |
| Actual principal invested beyond year end | £11m | £11m | £9m |
| Limit on principal invested beyond year end | £15m | £15m | £15m |
| Complied | Yes | Yes | Yes |

* 1. The table includes investments in strategic pooled funds of £9m as although these can usually be redeemed at short notice, the OPCC intends to hold these investments for at least the medium term.