**POLICE AND CRIME COMMISSIONER FOR HAMPSHIRE AND ISLE OF WIGHT**

**JOINT AUDIT COMMITTEE – 17 September 2024**

*Q1 Treasury Management Report 2024/25*

**REPORT OF THE CHIEF FINANCE OFFICER OF THE OFFICE OF THE POLICE AND CRIME COMMISSIONER**

1. **Purpose**
	1. The Police and Crime Commissioner for Hampshire (PCC) 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 2021 which requires the PCC to approve, as a minimum, treasury management semi-annual and annual outturn reports.
	2. This quarterly report provides an update on treasury management activity including the requirement in the 2021 Code of quarterly reporting of the treasury management prudential indicators. The non-treasury prudential indicators are incorporated in the normal quarterly revenue and capital monitoring reports.
2. **Recommendation**
	1. It is recommended that the Joint Audit Committee (JAC) considers the report and makes observations as appropriate.
3. **Executive Summary**
	1. The report fulfils the PCC’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 quarter one 2024/25.
	2. The PCC’s treasury management strategy was most recently updated and approved by the PCC in March 2024. The PCC 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 PCC’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 report sets out the performance of the treasury management function during Q1 2024/25, to include the effects of the decisions taken and the transactions executed in the first three months of the financial year.
	5. Overall responsibility for treasury management remains with the PCC. No treasury management activity is without risk and the effective identification and management of risk are therefore integral to the PCC’s treasury management objectives.
	6. All treasury activity has complied with the PCC’s Treasury Management Strategy and Investment Strategy for 2024/25, and all relevant statute, guidance and accounting standards. In addition, support in undertaking treasury management activities has been provided by the PCC’s treasury advisers, Arlingclose.
	7. The 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 PCC’s most recent Capital and Investment Strategy, complying with CIPFA’s requirement, was approved by the PCC in February 2024.
4. **External Context**
	1. The following sections outline the key economic themes in the UK against which investment and borrowing decisions have been made so far in 2024/25.

**Economic commentary**

* 1. UK headline consumer price inflation (CPI) stayed at the 2% target in June 2024 but the Bank of England (BoE) expects this to rise to 2.75% in the second half of this year, as declines in energy prices last year fall out of the annual comparison and reveal more clearly the prevailing persistence of domestic inflationary pressures. Wage growth has fallen but remains elevated and services inflation is higher than had been expected. The actual path of inflationary pressures will be key to the Monetary Policy Committee (MPC)’s decision making.
	2. Data released during the period showed that the UK economy had emerged from the technical recession at the end of 2023 to expand by 0.7% (upwardly revised from the initial estimate of 0.6%) in the first quarter of the calendar year. Monthly GDP data showed zero growth in April 2024 following an expansion of 0.4% in the previous month.
	3. Arlingclose, the authority’s treasury adviser, maintained its central view that 5.25% is the peak in Bank Rate. The MPC subsequently voted to cut Bank Rate by 25 basis points to 5.00% in their August 2024 meeting. Arlingclose maintains the view that further interest rates cuts remain likely towards the end of 2024. The risks over the medium term are deemed to be to the upside as while inflation has fallen to target, it is expected to pick up again later in the year and services price inflation and wage growth are still on the firmer side.

**Financial markets**

* 1. Sentiment in financial markets showed signs of improvement over the quarter, but bond yields remained volatile. Early in the period bond yields climbed steadily, but mixed signals from economic data and investors’ constant reassessment of when rate cuts might come caused a couple of fairly pronounced but short-lived dips in yield. Towards the end of the quarter yields rose once again and were generally higher than at the start of the period.

**Credit review**

* 1. Arlingclose maintained its advised recommended maximum unsecured duration limit on all banks on its counterparty list at 100 days.
	2. Credit default swap (CDS) prices are used as an indicator of credit risk, where higher premiums indicate higher perceived risks. CDS prices started and ended the quarter at broadly similar levels in the UK as they did for the European, Singaporean and Australian lenders on Arlingclose’s counterparty list, while Canadian banks generally trended modestly downwards.
	3. Financial market volatility is expected to remain a feature, at least in the near term and, CDS levels will be monitored for signs of ongoing credit stress. As ever, the institutions and durations on the PCC’s counterparty list recommended by Arlingclose remain under constant review.
1. **Local Context**
	1. On 31 March 2024, the PCC had net investments of £111.3m arising from its revenue and capital income and expenditure. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while balance sheet resources are the underlying resources available for investment. Table 1 lays out the various CFR elements and how they are financed, comparing the position at 31 March 2024 to the forecast position expected at 31 March 2025.

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| --- | --- | --- |
| **Table 1: Balance sheet summary** | **31/03/24Balance£m** | **31/03/25Forecast£m** |
| Total CFR | 51.1 | 74.1 |
| **External borrowing\*** | (19.4) | (19.0) |
| **Internal borrowing** | **31.6** | **55.1** |
| Less: Balance sheet resources | (143.0) | (118.5) |
| **Net investments** | **(111.3)** | **(63.4)** |

\* shows only loans to which the PCC is committed and excludes optional refinancing

* 1. The PCC’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. The treasury management position at 31 March 2024 and the change over the quarter is shown in Table 2 below.

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| --- | --- | --- | --- | --- |
| **Table 2: Treasury management summary** | **31/03/24Balance£m** | **Movement£m** | **30/06/24Balance£m** | **30/06/24Rate%** |
| Long-term borrowing | (19.0) | 0.0 | (19.0) | 4.24 |
| Short-term borrowing | (0.4) | 0.0 | (0.4) | 4.88 |
| **Total borrowing** | **(19.4)** | **0.0** | **(19.4)** | **4.25** |
| Long-term investments | 24.0 | 0.0 | 24.0 | 5.46 |
| Short-term investments | 40.5 | (16.0) | 24.5 | 5.25 |
| Cash and cash equivalents | 33.3 | 21.3 | 54.6 | 5.07 |
| **Total investments** | **97.8** | **5.3** | **103.1** | **5.20** |
| **Net treasury management investments** | **78.4** | **5.3** | **83.7** |  |

Note: the 31 March 2024 figures in Table 2 are taken from the balance sheet in the PCC’s accounts, but adjusted to exclude operational cash, accrued interest and other accounting adjustments, and therefore differ from Table 1.

* 1. The increase in net investments of £5.3m shown in Table 2 reflects the receipt of grant payments in advance of expenditure as well as a cash saving brought about by the prepayment of three years’ worth of employer pension contributions on 1 April 2023.
	2. The overall level of investments provides significant financial resilience for the PCC, albeit that the majority of the reserves are ringfenced and set aside for specific purposes; the expectation is that reserves will be drawn down significantly over the next few years, particularly to support the capital programme, major equipment purchase, IT infrastructure and device replacement, Operation Magenta and to fund inflation pressures.
1. **Borrowing Strategy and Activity**
	1. As outlined in the Treasury Management Strategy, the PCC’s chief objective when borrowing has been to strike an appropriately low risk balance between securing lower interest costs and achieving cost certainty over the period for which funds are required. The flexibility to renegotiate loans should the PCC’s long-term plans change is a secondary objective. The PCC’s borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. At the present time short term interest rates are higher than long term interest rates.
	2. This borrowing strategy has been monitored with the assistance of Arlingclose and has enabled the PCC to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk.
	3. CIPFA’s 2021 Prudential Code is clear that local authorities (including PCCs) must not borrow to invest primarily for financial return and that it is not prudent for local authorities to make any investment or spending decision that will increase the capital financing requirement and so may lead to new borrowing, unless directly and primarily related to the functions of the Authority. PWLB loans are no longer available to local authorities and PCCs planning to buy investment assets primarily for yield unless these loans are for refinancing purposes. The PCC has no plans to borrow to invest primarily for financial return, so is able to retain full access to the PWLB, however there are no plans to take on any new external borrowing.
	4. The PCC is a net investor and expects a negative liability benchmark up to and including 2026/27, meaning that there is not currently a requirement to undertake new borrowing either internally or externally. It is expected that a forecast reduction in balance sheet resources will result in a positive liability benchmark as at 31 March 2027, however the liability benchmarking will be at or below the current level of external borrowing, which indicates that no further borrowing will be necessary in the forecast period.
	5. At 30 June 2024 the PCC held £19.4m of loans as part of its strategy for funding previous years’ capital programmes. Outstanding loans on 30 June 2024 are summarised in Table 3 below.

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| --- | --- | --- | --- | --- | --- |
| **Table 3: Borrowing position** | **31/03/24Balance£m** | **Net movement£m** | **30/06/24Balance£m** | **30/06/24Weighted average rate%** | **30/06/24Weighted average maturity(years)** |
| Public Works Loan Board (PWLB) | (19.4) | 0.0 | (19.4) | 4.25 | 9.1 |
| **Total borrowing** | **(19.4)** | **0.0** | **(19.4)** | **4.25** | **9.1** |

Note: the figures in Table 3 at 31 March 2024 are from the balance sheet in the PCC’s accounts but adjusted to exclude accrued interest.

* 1. The PCC has considered it to be more cost effective in the near term to use internal resources than to use additional external borrowing. In the last three months, no existing loans have matured, and no additional borrowing has been secured.
1. **Treasury Investment Activity**
	1. The CIPFA Treasury Management in the Public Services Code of Practice and Cross-Sectoral Guidance Notes (revised in 2021) defines treasury management investments as investments that arise from the organisation’s cash flows or treasury risk management activity that ultimately represents balances that need to be invested until the cash is required for use in the course of business.
	2. The PCC holds invested funds, representing income received in advance of expenditure plus balances and reserves held. During the last 12 months, the PCC’s investment balances have ranged between £83.6m and £125.2m due to timing differences between income and expenditure. The investment position is shown in Table 4.

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| **Table 4: Treasury investment position** | **31/03/24 Balance** | **Net movement** | **30/06/24****Balance** | **30/06/24Income return** | **30/06/24Weighted average maturity** |
|  | **£m** | **£m** | **£m** | **%** | **(years)** |
| **Short term investments**  |  |  |  |  |  |
| Banks and building societies: |  |  |  |  |  |
| * Unsecured
 | 8.3 | (0.9) | 7.4 | 4.78 | 0.00 |
| * Secured
 | 5.0 | 0.0 | 5.0 | 4.31 | 0.68 |
| * High quality bonds
 | 5.0 | 0.0 | 5.0 | 5.03 | 0.45 |
| Money market funds | 25.0 | 17.2 | 42.2 | 5.21 | 0.00 |
| Government: |   |   |   |   |   |
| * Local authorities
 | 25.5 | (11.0) | 14.5 | 5.40 | 0.31 |
| * Treasury bills
 | 5.0 | (5.0) | 0.0 | N/A | N/A |
| * Supranational bonds
 | 0.0 | 5.0 | 5.0 | 5.06 | 0.47 |
| **Total** | **73.8** | **5.3** | **79.1** | **5.12** | **0.16** |
| **Long term investments**Banks and building societies: |  |  |  |  |  |
| * High quality bonds
 | 10.0 | 0.0 | 10.0 | 5.91 | 1.43 |
| Registered providers\* | 0.0 | 0.0 | 0.0 | N/A | N/A |
| Government |   |   |   |   |   |
| * Supranational bonds
 | 9.0 | 0.0 | 9.0 | 4.81 | 4.52 |
| Pooled property funds\*\* | 4.0 | 0.0 | 4.0 | 5.16 | N/A |
| Pooled equity funds\*\* | 1.0 | 0.0 | 1.0 | 7.97 | N/A |
| **Total** | **24.0** | **0.0** | **24.0** | **5.46** | 1.66 |
| **Total investments** | **97.8** | **5.3** | **103.1** | **5.20** | **0.51** |

\* Revolving credit facilities totalling £5m are in place with registered providers, currently not drawn. These agreements provide the PCC with an average non-utilisation fee of 0.30% per annum by reference to the undrawn amounts of the facilities.

\*\* The rate provided for the pooled property fund investment is reflective of annualised income returns over the 12 months to 30 June 2024 based on the market value of investments at the start of the year (30 June 2023).

Note: the figures in Table 4 at 31 March 2024 are from the balance sheet in the PCC’s accounts but adjusted to exclude operational cash, accrued interest and other accounting adjustments.

* 1. The increase in investment balances since the year end can primarily be attributed to timing differences between income and expenditure where grant monies have been received but not yet utilised, alongside cash savings as a result of the prepayment of employer pension contributions in April of 2023.
	2. Both the CIPFA Code and government guidance require the PCC to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the optimum rate of return, or yield. The PCC’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 PCC’s Treasury Management Strategy Statement (TMSS) sets out how it will manage and mitigate these risks.
	3. 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 PCC 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
	4. As demonstrated by the liability benchmark in this report, the PCC expects to be a long-term investor and treasury investments therefore include both short-term low risk instruments to manage day-to-day cash flows and longer-term instruments where limited additional risk is accepted in return for higher investment income to support local public services.
	5. Bank Rate remained at 5.25% through the quarter with short term interest rates largely around this level. Money market rates ranged between 5.19% and 5.23% at the end of June 2024.
	6. The progression of risk and return metrics are shown in the extracts from Arlingclose’s quarterly investment benchmarking in Table 5. These metrics monitor the internal investments of the portfolio, which is the total portfolio less both the pooled funds and the cash plus fund.

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| **Table 5: Investment benchmarking (excluding pooled funds)** | **Credit rating** | **Bail-in exposure** | **Weighted average maturity(days)** | **Rate of return** |
| 31.03.2024 | AA- | 36% | 289 | 5.27% |
| 30.06.2024 | AA- | 51% | 251 | 5.18% |
| Police & Fire Authorities | AA- | 68% | 39 | 4.81% |
| All LAs | A+ | 62% | 10 | 5.07% |

* 1. Table 5 shows that the average credit rating of the PCC’s investment portfolio has remained consistent at AA- and continues to earn a higher rate of return that the average comparable Police and Fire Authority but with lower exposure to bail-in risk. Bail-in exposure has increased slightly, owing to an increase in investment in Money Market Funds since the year end, which is due to increased liquidity following the receipt of grant and other income. This is also reflected in the portfolio’s weighted average maturity (WAM) reducing.

**Externally managed pooled funds**

* 1. £5m of the PCC’s investments are invested in externally managed strategic pooled funds where short-term security and liquidity are lesser considerations, and the objectives instead are regular revenue income and long-term price stability.
	2. UK equities enjoyed a positive quarter; the FTSE All Share index was buoyed in April 2024 by data showing the economy had emerged from the short, shallow recession in 2023. Sterling’s weakness against the dollar in April 2024 also provided a boost to UK stocks with overseas earnings. The energy, materials and mining sectors gained as the outlook for global manufacturing improved. Healthcare and financial stocks were also supported by good earnings data. The rally faded somewhat with the unexpected announcement in May 2024 of a general election in early July 2024.
	3. Dwindling prospects of policy rate cuts weighed on consumer discretionary stocks as well as on the UK real estate sector. Improvement in commercial property capital values was dampened by the asset class’s sensitivity to higher interest rates.
	4. Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the PCC’s medium- to long-term investment objectives are regularly reviewed. Strategic fund investments are made in the knowledge that capital values will move both up and down on months, quarters and even years; but with the confidence that over a three- to five-year period total returns should exceed cash interest rates.
	5. In April 2023 the Department for Levelling Up, Housing and Communities published the full outcome of the consultation on the extension of the statutory override on accounting for gains and losses on pooled investment funds. The override has been extended for 2 years until 31 March 2025 but no other changes have been made; whether the override will be extended beyond the new date is unknown but commentary to the consultation outcome suggests not. The PCC will discuss with Arlingclose the implications for the investment strategy and what action may need to be taken.
1. **Non-Treasury Investments**
	1. The definition of investments in CIPFA’s revised Treasury Management Code now covers all the financial assets of the PCC as well as other non-financial assets which the PCC holds primarily for financial return. Investments that do not meet the definition of treasury management investments (i.e. management of surplus cash) are categorised as either for service purposes (made explicitly to further service objectives) and or for commercial purposes (made primarily for financial return).
	2. Investment Guidance issued by DLUHC also broadens the definition of investments to include all such assets held partially or wholly for financial return. The Investment Guidance applies to all authorities defined as local authorities under the Local Government Act 2003, section 23, which includes Police and Crime commissioners.
	3. This could include the direct purchase of land or property and any such loans and investments will be subject to the PCC’s normal approval processes for revenue and capital expenditure and need not comply with the treasury management strategy. The PCC does not have any existing non-treasury investments.
2. **Compliance Report**
	1. The PCC CFO confirms compliance of all treasury management activities undertaken during the quarter with the CIPFA Code of Practice and the PCC’s approved Treasury Management Strategy.
	2. Compliance with the authorised limit and operational boundary for external debt, is demonstrated in Table 6.

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| --- | --- | --- | --- | --- | --- |
| **Table 6: Debt limits** |  **Q1 2024/25 Maximum** | **30/06/24 Actual** | **2024/25 Operational Boundary** | **2024/25 Authorised Limit** | **Complied** |
|  | **£m** | **£m** | **£m** | **£m** |  |
| Borrowing | (20.2) | (19.4) | (67.9) | (85.3) |  |
| Leases |  (26.8) | (26.8) | (36.8) | (36.8) |  |
| **Total debt** | **(47)** | **(46.2)** | **(104.7)** | **(122.1)** |  |

* 1. Since the operational boundary is a management tool for in-year monitoring it is not significant if the operational boundary is breached on occasions due to variations in cash flow, and this is not counted as a compliance failure. However, this limit has not been breached during the financial year to date.
1. **Treasury Management Indicators**
	1. As required by the 2021 CIPFA Treasury Management Code, the PCC monitors and measures the following treasury management prudential indicators.

**Liability benchmark**

* 1. This indicator compares the PCC’s actual existing borrowing against a liability benchmark that has been calculated to show the lowest risk level of borrowing. The liability benchmark is an important tool to help establish whether the PCC is likely to be a long-term borrower or long-term investor in the future, and so shape its strategic focus and decision making. It represents an estimate of the cumulative amount of external borrowing the PCC must hold to fund its current capital and revenue plans while keeping treasury investments at the minimum level required to manage day-to-day cash flow.

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| --- | --- | --- | --- | --- |
| **Table 7: Liability benchmark** | **31/03/24** | **31/03/25** | **31/03/26** | **31/03/27** |
| **Actual** **£m**  | **Forecast** **£m** | **Forecast** **£m** | **Forecast** **£m** |
| Loan CFR | 49.3 | **48.4** | **46.8** | **45.2** |
| Less: Balance sheet resources | (134.6) | (118.5) | (92) | (61.7) |
| **Net loans requirement** | **(85.3)** | **(70.1)** | **(45.2)** | **(16.5)** |
| Plus: Liquidity allowance | 10.0 | 10.0 | 10.0 | 10.0 |
| **Liability benchmark** | **(75.3)** | **(60.1)** | **(35.2)** | **(6.5)** |

**Graph 1: Liability benchmark**

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* 1. The PCC is a net investor and as the Table 7 and Graph 1 shows, the PCC expects a negative liability benchmark across the forecast period (demonstrated by no visible liability benchmark line on the graph until into 2027), meaning that there is not a requirement to borrow for the foreseeable future.

**Interest rate exposures**

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

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| --- | --- | --- |
| **Table 8: Interest rate risk indicator** | **30/06/2024** | **Impact of +/-1% interest rate change£m** |
| **Actual £m**  |
| Sums subject to variable interest rates:  |  |  |
| Investment | 84.1 | 0.8 |
| Borrowing | (0.4) | (0.0) |

* 1. Fixed rate investments and borrowings are those where the rate of interest is fixed for 12 months. Instruments and loans that mature within 12 months are classed as variable rate.

**Maturity structure of borrowing**

* 1. This indicator is set to control the PCC’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.

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| --- | --- | --- | --- | --- |
| **Table 9: Maturity structure of borrowing** | **30/06/24Actual** | **Upper Limit** | **Lower Limit** | **Complied** |
| Under 12 months | 2% | 50% | 0% |  |
| 12 months and within 24 months | 0% | 50% | 0% |  |
| 24 months and within 5 years | 0% | 50% | 0% |  |
| 5 years and within 10 years | 62% | 75% | 0% |  |
| 10 years and within 20 years | 36% | 100% | 0% |  |
| 20 years and above | 0% | 100% | 0% |  |

**Long-term Treasury Management Investments**

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

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| --- | --- | --- | --- | --- |
| **Table 10: Long-term Treasury Management Investments** | **2024/25** | **2025/26** | **2026/27** | **No fixed date** |
| Actual principal invested beyond year end | £19m | £5m | £5m | £5m |
| Limit on principal invested beyond year end | £45m | £45m | £45m | £5m |
| Complied |  |  |  |  |

* 1. Long-term investments with no fixed maturity date include strategic pooled funds, real estate investment trusts and directly held equity but exclude money market funds and bank accounts with no fixed maturity date as these are considered short-term.