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

**JOINT AUDIT COMMITTEE – 19 November 2024**

*Quarter 2 Mid-year 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 Chartered Institute of Public Finance and Accountancy’s Treasury Management in the Public Services: Code of Practice (the CIPFA Code) which requires the PCC to approve, as a minimum, four treasury management reports a year, including an annual strategy and outturn report.
	2. This report provides an update on treasury management activity in the first half of 2024/25 and meets the requirement in the 2021 Code of quarterly reporting of the treasury management prudential indicators.
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 the first half of 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 the first half of 2024/25, to include the effects of the decisions taken and the transactions executed in the first six 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. One incidence of non-compliance with the Treasury Management Strategy and Investment Strategy for 2024/25 occurred in the year, where the PCC’s existing borrowing passively breached the maturity structure of borrowing limit due to changes in maturity. Further details are provided in the Compliance section of this report.
	7. Apart from this occurrence, all other treasury activity has complied with the PCC’s Treasury Management Strategy and Investment Strategy 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.
	8. 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 remained around the Bank of England (BoE) target during the second quarter of the financial year, with July and August 2024 returning annual rates of 2.2% as was expected, due to base effects from energy prices. Core and services price inflation remained higher at 3.6% and 5.6% respectively in August 2024.
	2. The UK economy continued to expand over the period, albeit slowing from the 0.7% gain in the first calendar quarter to 0.5% (downwardly revised from 0.6%) in the second. Of the monthly figures, the economy was estimated to have registered no growth in July 2024. With headline inflation lower, the BoE cut the Bank Rate from 5.25% to 5.00% at the August 2024 Monetary Policy Committee (MPC) meeting.
	3. Arlingclose, the Police and Crime Commissioner’s treasury adviser, maintained its central view that Bank Rate would steadily fall from the 5.25% peak, with the first cut that took place in August 2024 being followed by a series of further cuts, with November 2024 the likely next one, taking Bank Rate down to around 3% by the end of 2025.

**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 were generally lower at the end of the period compared to the beginning for the vast majority of the names on UK and non-UK lists. Price volatility over the period was also generally more muted compared to previous periods.
	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 Police and Crime Commissioner’s counterparty list recommended by Arlingclose remain under constant review.

**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** | **31.7** | **55.1** |
| Less: Balance sheet resources | (143.0) | (118.5) |
| **Net investments** | **(111.3)** | **(63.4)** |

* 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 30 June 2024 and the change over the quarter to 30 September 2024 is shown in Table 2.

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| --- | --- | --- | --- | --- |
| **Table 2: Treasury management summary** | **30/06/24Balance£m** | **Movement£m** | **30/09/24Balance£m** | **30/09/24Rate%** |
| 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 | 2.0 | 26.0 | 5.11 |
| Short-term investments | 24.5 | 48.5 | 73.0 | 5.07 |
| Cash and cash equivalents | 54.6 | 2.3 | 56.9 | 4.98 |
| **Total investments** | **103.1** | **52.8** | **155.9** | **5.04** |
| **Net treasury management investments** | **83.7** | **52.8** | **136.5** |  |

* 1. The increase in net investments of £52.8m shown in Table 2 reflects no change in borrowing and a £52.8m increase in investment balances. This rise is due to 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 PCC’s 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 September 2024 the PCC held £19.4m of loans as part of its strategy for funding previous years’ capital programmes. Outstanding loans on 30 September 2024 are summarised in Table 3.

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| **Table 3: Borrowing position** | **30/06/24Balance£m** | **Net movement£m** | **30/09/24Balance£m** | **30/09/24Weighted average rate%** | **30/09/24Weighted average maturity(years)** |
| Public Works Loan Board (PWLB) | (19.4) | 0.0 | (19.4) | 4.25 | 8.8 |
| **Total borrowing** | **(19.4)** | **0.0** | **(19.4)** | **4.25** | **8.8** |

* 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 Code 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 financial year to date, the PCC’s investment balances have ranged between £83.6m and £172.2m due to timing differences between income and expenditure. The investment position at 30 June 2024 and the changes in the quarter to 30 September 2024 are shown in Table 4.

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| **Table 4: Treasury investment position** | **30/06/24 Balance** | **Net movement** | **30/09/24****Balance** | **30/09/24Income return** | **30/09/24Weighted average maturity** |
|  | **£m** | **£m** | **£m** | **%** | **(years)** |
| **Short term investments**  |  |  |  |  |  |
| Banks and building societies: |  |  |  |  |  |
| * Unsecured
 | 7.4 | 0.4 | 7.8 | 4.88 | 0.00 |
| * Secured
 | 5.0 | 0.0 | 5.0 | 4.31 | 0.43 |
| * High quality bonds
 | 5.0 | 9.5 | 14.5 | 5.30 | 0.38 |
| Money market funds | 42.2 | 6.9 | 49.1 | 4.99 | 0.00 |
| Government: |   |   |   |   |   |
| * Local authorities
 | 14.5 | 25.0 | 39.5 | 5.08 | 0.44 |
| * Treasury bills
 | 0.0 | 5.0 | 5.0 | 5.10 | 0.27 |
| * Supranational bonds
 | 5.0 | 4.0 | 9.0 | 5.03 | 0.44 |
| **Total** | **79.1** | **50.8** | **129.9** | **5.03** | **0.23** |
| **Long term investments**Banks and building societies: |  |  |  |  |  |
| * High quality bonds
 | 10.0 | (1.0) | 9.0 | 5.35 | 1.39 |
| Registered providers\* | 0.0 | 0.0 | 0.0 | N/A | N/A |
| Government |   |   |  |  |  |
| * Supranational bonds
 | 9.0 | 3.0 | 12.0 | 4.82 | 2.24 |
| Pooled property funds\*\* | 4.0 | 0.0 | 4.0 | 4.75 | N/A |
| Pooled equity funds\*\* | 1.0 | 0.0 | 1.0 | 7.72 | N/A |
| **Total** | **24.0** | **2.0** | **26.0** | **5.11** | **1.52** |
| **Total investments** | **103.1** | **52.8** | **155.9** | **5.04** | **0.45** |

\* 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 rates provided for pooled fund investments are reflective of annualised income returns over the 12 months to 30 September 2024 based on the market value of investments at the start of the year (1 October 2023).

* 1. The increase in investment balances since the end of Quarter 1 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. Specifically, the PCC receives its £58m pension top-up grant in July each year, and due to its significance both the minimum and maximum cash balances are generally seen during the second quarter of the financial year.
	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.
	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 where available and appropriate. 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 services. The PCC has invested in pooled funds as part of its Treasury Management strategy. The existing portfolio of strategic pooled funds will be maintained to diversify risk into different asset classes and boost investment income as part of the implementation of the wider Treasury Management strategy ensuring it is investing its funds prudently, having regard to the security and liquidity of its treasury investments before seeking the optimum rate of return, or yield. By investing in a diversified portfolio in respect of yield this meets the PCC’s aim of protecting reserves from high inflation.
	5. Bank Rate reduced from 5.25% to 5.00% in August 2024 with short term interest rates largely being around these levels. Average money market rates fell from 5.21% at the end of June 2024 to 5.00% at the end of September 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.

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| **Table 5: Investment benchmarking (excluding pooled funds)** | **Credit rating** | **Bail-in exposure** | **Weighted average maturity(days)** | **Rate of return** |
| 30.06.2024 | AA- | 51% | 251 | 5.18% |
| 30.09.2024 | AA- | 41% | 205 | 5.03% |
| Police & Fire Authorities | AA- | 68% | 31 | 4.75% |
| All Las | A+ | 61% | 11 | 4.91% |

* 1. Table 5 shows the positive position that the average credit rating of the PCC’s investment portfolio has remained consistent at AA- and although the average interest rate has reduced due to the cut in the Base Rate, the PCC’s investments continue to earn a higher rate of return than the average comparable Police and Fire Authority but with lower exposure to bail-in risk. Bail-in exposure has reduced over the quarter, owing to an increase in investment in secured short-dated bonds and local authority lending, both of which are not subject to bail-in risk. 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. Over the 12 months to 30 September 2024 these funds generated an average total return of 4.87%, comprising a 5.59% income return which is used to support services in year, and 0.72% of an unrealised capital loss.
	2. By comparison, over the holding period of these investments, the pooled funds have generated a total return of 3.56% pa, comprising 4.28% pa average income return and -0.84% pa average capital return. There is currently an unrealised capital loss of £411,000 on the pooled funds, and it is hoped that the capital value of these investments will recover over the medium term. Regardless of this, an income return of 4.28% pa represents good value over a period where generally interest rates have remained low.
	3. The first six months of 2024/25 were marked by ongoing market volatility, although trending downward as policymakers kept rates at a restrictive level in light of persistent core inflation until nearly the end of the period, when the MPC, Federal Reserve, and European Central Bank (ECB) began to deliver rate cuts and signal a shift towards loosening monetary policy.
	4. Stock markets across the UK, Europe, and US were buoyed by hopes of rate cuts over the first half of the financial year and UK equities saw growth in small and mid-sized companies. The FTSE All Share index was marginally lower at the end of the 6-month period at 4529 on 30/9/24 v 4338 on 31/3/24.
	5. UK commercial property values started to stabilise, then improve slightly towards the end of the period, with interest rates being cut from their peak and investor attention turning to the timing of further interest rate cuts. Transaction activity remains somewhat subdued but signs of recovery in the occupier and rental markets as well as moderate economic growth and further falling interest rates are hoped to be favourable for an improving property sector outlook over the medium term. Capital growth is expected to be gradual while income levels remain strong for many sub-sectors.
	6. 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.
	7. In April 2023 the Department for Levelling Up, Housing and Communities (DLUHC) 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 the Department previously known as 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 Chief Finance Officer (CFO) reports that all treasury management activities undertaken during the quarter complied fully with the principles in the Treasury Management Code 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** | **H1 2024/25 Maximum****£m** | **30/09/24 Actual****£m** | **2024/25 Operational Boundary £m** | **2024/25 Authorised Limit****£m** |  **Complied?** |
| Borrowing | (20.2) | (19.4) | (67.9) | (85.3) |  |
| Leases |  (26.8) | (26.8) | (36.8) | (36.8) |  |
| **Total debt** | **(47.0)** | **(46.2)** | **(104.7)** | **(122.1)** |  |

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) | (92.0) | (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 show, 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** | **30/09/2024** | **Impact of +/-1% interest rate change£m** |
| **Actual £m**  |
| Sums subject to variable interest rates:  |  |  |
| Investment | 134.9 | 1.3 |
| 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** | **30/09/24Actual** | **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 | 83% | 75% | 0% | x |
| 10 years and within 20 years | 15% | 100% | 0% |  |
| 20 years and above | 0% | 100% | 0% |  |

* 1. In Quarter 2, £4m of long-term borrowing held by the PCC was re-classified within the maturity structure owing to the maturity date of the loans falling below the 10 year threshold for the first time. This had the effect of increasing the proportion of the PCC’s loan portfolio in the ‘5 years and within 10 years’ category above the upper limit of 75%, resulting in a breach.
	2. It should be reiterated that this was not caused by any additional borrowing being taken, but rather an expected change in the maturity structure of the loans portfolio as the borrowing moves towards maturity and the PCC’s total debt reduces. An amendment to the Strategy to better reflect the maturity structure of the current debt portfolio is proposed below and will be recommended to the PCC.

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| --- | --- | --- |
| **Table 10: Updated maturity structure of borrowing proposal** | **Upper Limit** | **Lower Limit** |
| Under 12 months | 50% | 0% |
| 12 months and within 24 months | 50% | 0% |
| 24 months and within 5 years | 50% | 0% |
| 5 years and within 10 years | 100% | 0% |
| 10 years and within 20 years | 100% | 0% |
| 20 years and above | 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 11: Long-term Treasury Management Investments** | **2024/25** | **2025/26** | **2026/27** | **No fixed date** |
| Actual principal invested beyond year end | £21m | £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.