Peter McCall

Treasury Management Activities 2022/23 Quarter 4 (January to March 2023) and Annual Report 2022/23

PFCC Executive Team 23 May and JAC Meeting 30 May 2023

Purpose of the Report

The purpose of this paper is to report on the Treasury Management Activities (TMA), which have taken place during the period January to March 2023, in accordance with the requirements of CIPFA's Code of Practice on Treasury Management.

TMA are undertaken in accordance with the Treasury Management Strategy Statement (TMSS) and Treasury Management Practices (TMPs) approved by the Commissioner in February each year.

Recommendations

The Commissioner is asked to note the contents of this report.

JAC Members are asked to note the contents of this report. The report is provided as part of the arrangements to ensure members are briefed on Treasury Management and maintain an understanding of activity in support of their review of the annual strategy.

Economic Background

Against a backdrop of stubborn inflationary pressures, the easing of Covid restrictions in most developed economies, the Russian invasion of Ukraine, and a range of different UK Government policies, it is no surprise that UK interest rates have been volatile right across the curve, from Bank Rate through to 50-year gilt yields, for all of 2022/23. Bank Rate increased steadily throughout 2022/23, starting at 0.75% and finishing at 4.25%.

CPI inflation picked up to what should be a peak reading of 11.1% in October, although hopes for significant falls from this level will very much rest on the movements in the gas and electricity markets, as well as the supply-side factors impacting food prices. On balance, most commentators expect the CPI measure of inflation to drop back towards 4% by the end of 2023. As of February 2023, CPI was 10.4%.

The UK unemployment rate fell through 2022 to a 48-year low of 3.6%, and this despite a net migration increase of ≈500k. Without an increase in the labour force participation rate, it is hard to see how the UK economy will be able to grow its way to prosperity, and with average wage increases running at over 6% the MPC will be concerned that wage inflation will prove just as sticky as major supply-side shocks to food and energy.

It is anticipated the Bank of England will be keen to loosen monetary policy when the worst of the inflationary pressures are behind us – but that timing will be one of fine judgment:

-if the cut is too soon inflationary pressures may well build up further.

-if the cut is too late then any downturn or recession may be prolonged.

Link Treasury, the PFCC'S advisors, feel that there is still scope for an early Christmas present for households with a December rate cut priced in, ahead of further reductions in 2024 and 2025.

TM Operations and Performance Measures

The Commissioners day to day TMA are undertaken in accordance with the TMSS. The TMSS establishes an investment strategy with limits for particular categories of investment and individual counterparty limits within the categories.

Outstanding Investments: As at 31 March 2023 the total value of investments was **£12.940m** and all were within TMSS limits.

The chart below shows the outstanding investments at 31 March by category.

Category	Category Limit (£m)	Investments at 31 Mar (£m)	Compliance with Limit
1 - Banks Unsecured	20	0.513	Yes
2 - Banks Secured	20	0.000	Yes
3 - Government (inc LA)	10	0.000	Yes
4 - Registered Providers	10	0.000	Yes
5 - Pooled Funds	15	12.427	Yes
Total		**12.940**	

A full list of the investments that make up the balance of £12.940m is provided at **Appendix A**.

Investment Activity: During quarter 4 a total of 3 investments with a combined value of £4.95m were made within TM categories 1-3 (banks unsecured, banks secured and Government). In addition to these there were regular smaller investments in category 5 (money market pooled funds).

Non-specified investments: The TMSS sets a limit for investments with a duration of greater than 364 days at the time the investment is made (known as non-specified investments), this limit is £5m. At 31 March the Commissioner had no investments meeting this description.

Investment Income: The base budget for investment interest receivable in 2022/23 was set at £10k based on the interest rate predictions at the time. The budget forecast was quickly revised to £170k in quarter 1, £300k in quarter 2 and £380k in quarter 3. The actual income achieved against this target was £437k. This was as a result of the numerous base rate rises throughout the year as shown in the table below:

Date	Increase	Rate
17/03/2022		0.75%
05/05/2022	0.25%	1.00%
16/06/2022	0.25%	1.25%
04/08/2022	0.50%	1.75%
22/09/2022	0.50%	2.25%
03/11/2022	0.75%	3.00%
15/12/2022	0.50%	3.50%
02/02/2023	0.50%	4.00%
23/03/2023	0.25%	4.25%

The average return on investment during quarter 4 was 3.45%. As a measure of investment performance, the rate achieved on maturing investments of over 3 months in duration would normally be compared with the average BOE base rate for the period of the investment.

The table below illustrates the rate achieved on the four maturing investments of over three months duration in quarter 4 compared with the average base rate for the duration of the investment.

Borrower	Value £m	Period (Months)	Actual Rate (%)	Average Base Rate (%)
Debt Management Office	2.00	3.77	3.04%	3.45%
Treasury bills	2.00	4.67	2.96%	3.56%
Treasury bills	1.65	6.07	2.06%	2.59%
Santander CD	2.00	4.20	3.58%	3.66%

Cash Balances: The aim of the TMSS is to invest surplus funds and minimise the level of un-invested cash balances. The actual un-invested cash balances for the period January to March are summarised in the table below:

Quarter 4	Number of Days	Average Balance £	Largest Balance £
Days In Credit	89	95,658	2,159,228
Days Overdrawn	1	(956,283)	(956,283)

There were a number of occasions where the bank balance exceeded the target balance of £7.5k as the practice of sweeping smaller balances daily into the liquidity select account was halted in August 2021. The time taken to perform and verify the transfers outweighed the lost interest from holding higher balances in the main fund. Both the main fund and liquidity select account are held at the Commissioners main bank (the NatWest) so there was no change to the risk profile.

There was one occurrence where the credit balance was higher than would be within normal operating levels. In March 2023 a £2m grant was received into the PCC's main fund account. The funds were held overnight in this account whilst the correct treatment was determined as the grant was in relation to Fire and Rescue Authority capital expenditure rather than belonging to the PCC or Constabulary. The funds, including interest earned, were transferred to the Fire bank account at the beginning of April.

There was one instance in the fourth quarter where the account was overdrawn. A misunderstanding meant that £1m cash was held in a third-party bank account in the name of the PCC rather than being transferred to the PCC's main bank account. This was not discovered until after the deadline with the Money Market Funds so there were no other source of funds available to prevent the overdrawn balance.

Loan Activity: There were no external loans in place on the 31 March 2023.

Prudential Indicators

In accordance with the Prudential Code, the TMSS includes a number of measures known as Prudential Indicators which determine if the TMSS meets the requirements of the Prudential Code in terms of ***Affordability, Sustainability** and **Prudence***.

An analysis of the current position with regard to those prudential indicators for the financial year 2022/23 is provided at **Appendix B**. The analysis confirms that the Prudential Indicators set for 2022/23 have all been complied with.

Annual Report on Treasury Management Operations 2022/23

Treasury Strategy: In February 2022 the Commissioner approved the 2022/23 Treasury Management Strategy Statement (TMSS). The TMSS incorporated the investment and borrowing strategies for the 2022/23 financial year. The investment strategy approved for 2022/23 was largely the same as had been adopted for the previous year. The limits for each category of investment were based on the relative security of each class of financial institution and a percentage of the estimated balances, which would be available for investment during the year.

In relation to borrowing, the Commissioner has an underlying need to borrow funds to finance the capital programme, which is measured by the Capital Financing requirement (CFR).

The CFR at the start of 2022/23 amounted to £22.107m (including £4.197m relating to the PFI agreement for West Cumbria TPA HQ in Workington) leaving a £17.910m exposure to external borrowing at some time in the future, which is presently being covered by the use of internal funds (reserves).

The closing CFR for 2022/23 is £21.468m, of which £3.965m relates to the PFI thereby leaving a £17.503m exposure to the requirement to undertake external borrowing at some point.

During 2022/23 the Commissioner has maintained this strategy of using cash balances, arising primarily from reserves, to meet the cash flow commitments and was not therefore compelled to borrow.

Although long term borrowing rates remained relatively low during 2022/23, a conscious decision was made to defer long term financing decisions as the short term cost of carrying debt (i.e. the differential between the borrowing rate estimated at 4.97% for 20 years fixed rate and the rate of 4.8% available as when such funding was invested for 1 year), as this would have had an adverse effect on the revenue budget for the year and the immediate outlook period.

The provision of treasury management advice services is through a contract with Link Asset Services Ltd.

The Commissioner, in consultation with the treasury advisors continues to look for the most opportune time to undertake any longer term borrowing to fund the capital financing requirement.

Key Statistics

Principal:

Number of investments placed during 2022/23 was 99 (123 in 2021/22).

Value of investments placed during 2022/23 was **£162.728m** (£133.937m in 2021/22).

Of these investments made, 98 were to external counterparties and as such will have attracted a £10 transfer fee per transaction. The transfer to the NatWest Liquidity Select account for overnight money is classed as an inter-account transfer' as the NatWest holds the Commissioner's main bank account. This type of transfer is free although we do pay a small fee to access the internet banking site.

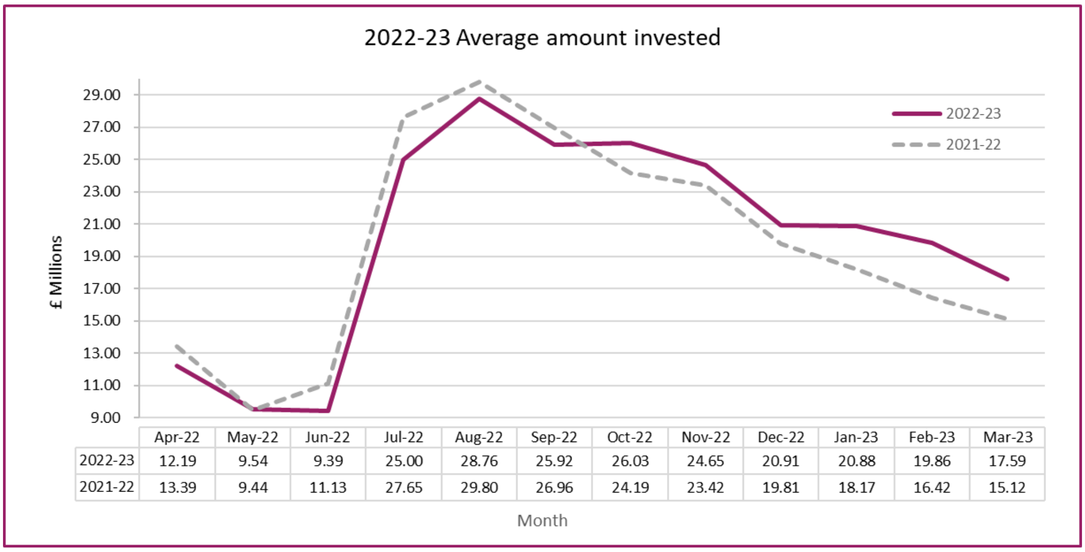
The **average** daily investment balance during 2022/23 was **£20.082m** (£19.661m in 2021/22).

The **highest** daily investment balance in 2022/23 was **£29.197m** (£34.171m in 2021/22)

The **lowest** daily investment balance in 2022/23 was **£4.764m** (£5.873m in 2021/22).

A detailed breakdown of the closing balance invested as at 31 March 2023 is provided at **Appendix A.**

The level of cash reserves available to invest has followed the same pattern as seen in previous years. Following the introduction of the Home Office Police Pensions Grant in 2007/08, there has been an annual spike in investments in July, when the majority of the grant is received, followed by a gradual decline in balances as pension payments are made throughout the remainder of the year.



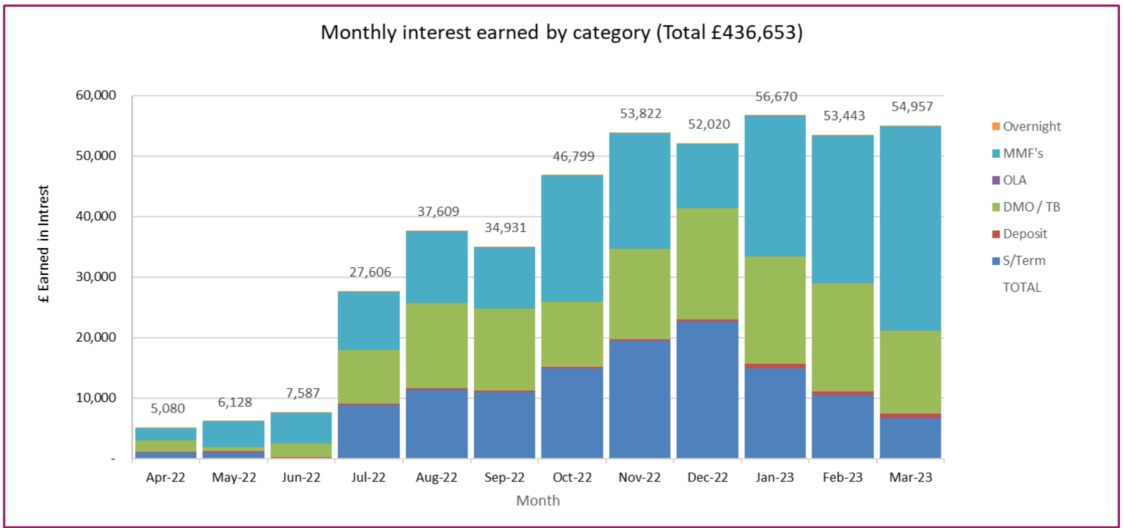
	Apr-22	May-22	Jun-22	Jul-22	Aug-22	Sep-22	Oct-22	Nov-22	Dec-22	Jan-23	Feb-23	Mar-23
2022-23	12.19	9.54	9.39	25.00	28.76	25.92	26.03	24.65	20.91	20.88	19.86	17.59
2021-22	13.39	9.44	11.13	27.65	29.80	26.96	24.19	23.42	19.81	18.17	16.42	15.12

This chart illustrates the monthly average amounts invested during 2022/23 (with monthly comparatives for 2021/22).

Key Statistics

Interest:

A total of £436,653k was earned in 2022/23 (£9k in 2021/22) from the Commissioner's treasury management activities and can be broken down as follows:



This chart illustrates the monthly Interest receipts during 2022/23 – by category of investment

The average return on investments for 2022/23 was 2.17% (0.05% in 2021/22). The base rate started the year at 0.75% and was increased 8 times towards the end of the financial year as follows:

Date	Increase	Rate
17/03/2022		0.75%
05/05/2022	0.25%	1.00%
16/06/2022	0.25%	1.25%
04/08/2022	0.50%	1.75%
22/09/2022	0.50%	2.25%
03/11/2022	0.75%	3.00%
15/12/2022	0.50%	3.50%
02/02/2023	0.50%	4.00%
23/03/2023	0.25%	4.25%

The table above shows the outturn on investment interest as £436,653k for 2022/23 which is considerably above the £10k base budget. The base budget was set at a time when interest rates were at their lowest (even negative in some cases) and fluctuating on a daily basis. In each quarterly treasury management activities report the latest expected outturn has been reported, namely, June £170k, September £300k and December £280k.

After another 0.25% rise to 4.5% in May 2023 it is now expected that this will be the peak.

Treasury Operations - Investments:

As discussed above the aim of the Treasury Management Strategy is to invest surplus cash and minimise the level of un-invested cash balances, whilst limiting risks to the Commissioner's funds.

Actual un-invested balances for 2022/23 for the Commissioner's main bank account are summarised in the table below:

2022/23	Number of Days	Average Balance £	Largest Balance £
Days In Credit	364	69,017	2,159,228
Days Overdrawn	1	(956,283)	(956,283)

The largest credit and overdrawn balance occurred during quarter 4 and have already been explained in the quarter 4 review section of this report.

Treasury Operations – Borrowing:

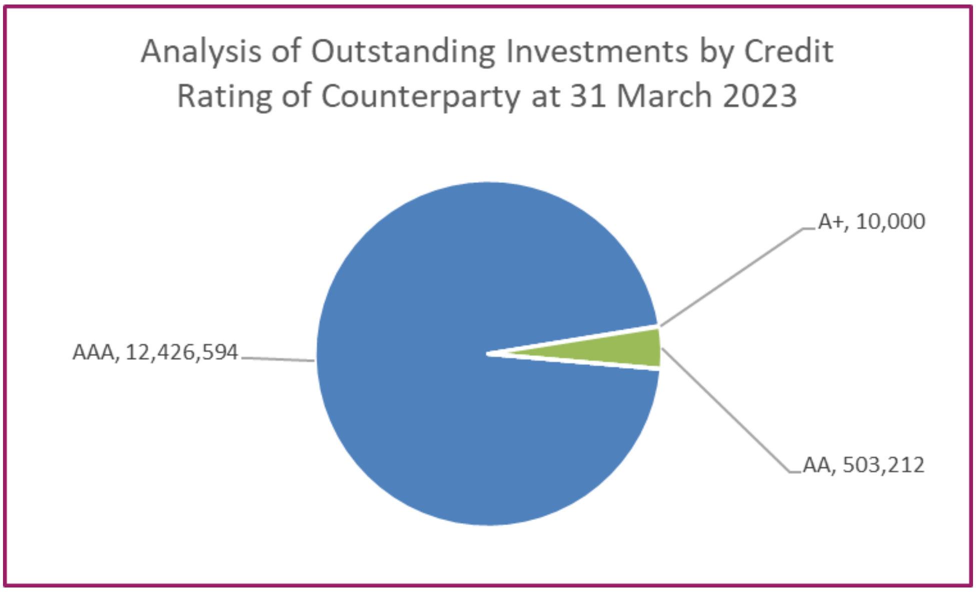
During April 2022 the short-term borrowing from two local authorities was repaid in full. A combination of investing excess cash in fixed deposits and unusually high creditors payment runs (including pension retirement lump sums) led to a cash shortfall over the 31 March 2022 year end. The loans were for £3m each, for a maximum of 16 days and cost £1,264.93 in interest.

Compliance with Prudential Indicators

All treasury related Prudential Indicators for 2022/23, which were set in February 2022 as part of the annual Statement of Treasury Management Strategy, have been complied with. Further details can be found at **Appendix B**.

Appendix A
Investment Balance at 31 March 2023

Category/Institution	Credit Rating	Investment Date	Investment Matures	Days to Maturity	Rate (%)	Counterparty Total (£)
Category 1 - Banks Unsecured (Includes Banks & Building Societies)						
Svenska Handelsbanken (Deposit Acc)	AA	Various	On Demand	N/A	1.70%	503,212
NatWest (Liquidity Select Acc)	A+	31/03/2023	03/04/2023	O/N	1.00%	10,000
						513,212
Category 2 - Banks Secured (Includes Banks & Building Societies)						
None						0
						0
Category 3 - Government (Includes HM Treasury and Other Local Authorities)						
None						0
						0
Category 4 - Registered Providers (Includes Providers of Social Housing)						
None						0
						0
Category 5 - Pooled Funds (Includes AAA rated Money Market Funds)						
Invesco	AAA	Various	On demand	O/N	3.031%	2,780,000
BlackRock	AAA	Various	On demand	O/N	2.850%	2,800,000
Fidelity	AAA	Various	On demand	O/N	3.131%	1,306,594
Goldman Sachs	AAA	Various	On demand	O/N	2.908%	3,640,000
Aberdeen Standard	AAA	Various	On demand	O/N	3.640%	1,900,000
						12,426,594
Total						**12,939,806**



Note – The credit ratings in the table & chart relate to the standing as at 31 March 2023, these ratings are constantly subject to change.

Appendix B
Prudential Indicators 2022/23

Treasury Management Indicators

Indicator		Test	Result	RAG
The Authorised Limit *The authorised limit represents an upper limit of external borrowing that could be afforded in the short term but may not be sustainable. It is the expected maximum borrowing needed with some headroom for unexpected movements. This is a statutory limit under section3(1) of the local government Act 2003.*		**TEST - Is current external borrowing within the approved limit**	**YES**	
The Operational Boundary *The operational boundary represents an estimate of the most likely but not worse case scenario. It is only a guide and may be breached temporarily due to variations in cash flow.*		**TEST - Is current external borrowing within the approved limit**	**YES**	
Actual External Debt *It is unlikely that the Commissioner will actually exercise external borrowing until there is a change in the present structure of investment rates compared to the costs of borrowing.*		**TEST - Is the external debt within the Authorised limit and operational boundry**	**YES**	
Gross and Net Debt *The purpose of this indicator is to highlight a situation where the Commissioner is planning to borrow in advance of need.*		**TEST - Is the PCC planning to borrow in advance of need**	**NO**	
Maturity Structure of Borrowing *The indicator is designed to exercise control over the Commissioner having large concentrations of fixed rate debt needing to be repaid at any one time.*		**TEST - Does the PCC have large amounts of fixed rate debt requiring repayment at any one time**	**NO**	
Upper Limit for total principal sums invested for over 365 Days *The purpose of this indicator is to ensure that the Commissioner has protected himself against the risk of loss arising from the need to seek early redemption of principal sums invested.*		**TEST - Is the value of long term investments witin the approved limit**	**YES**	

Prudential indicators

Indicator		Test	Result	RAG
Ratio of Financing Costs to Net Revenue Stream *This is an indicator of affordability and highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of revenue budget required to meet financing costs.*		**TEST - Is the ratio of capital expenditure funded by revenue within planned limits**	**YES**	
Net Borrowing and the Capital Financing Requirement *This indicator is to ensure that net borrowing will only be for capital purposes. The Commissioner should ensure that the net external borrowing does not exceed the total CFR requirement from the preceding year plus any additional borrowing for the next 2 years.*		**TEST - Is net debt less than the capital financing requirement**	**YES**	
Capital Expenditure and Capital financing *The original and current forecasts of capital expenditure and the amount of capital expenditure to be funded by prudential borrowing for 2022/23.*		**TEST - Is the current capital outurn within planned limits**	**YES**	
Capital Financing Requirement *The CFR is a measure of the extent to which the Commissioner needs to borrow to support capital expenditure only. It should be noted that at present all borrowing has been met internally.*		**TEST - Is the capital financing requirment within planned limits**	**YES**	

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