



Annual Treasury Management Review

2021/22

Cambridgeshire Police & Crime Commissioner
July 2022

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1. Introduction

The Police & Crime Commissioner (the PCC) is required by regulations issued under the Local Government Act 2003 to produce an annual treasury management review of activities and the actual prudential and treasury indicators for 2021/22. This report meets the requirements of both the CIPFA Code of Practice on Treasury Management (the Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code). The Prudential Code sets prudential and treasury indicators which are required to be reported on. The full set of indicators is provided in Appendix 1 and referred to in the report where appropriate.

During 2021/22 the minimum reporting requirements were that the PCC should receive the following reports:

- an annual treasury strategy in advance of the year
- a mid-year (minimum) treasury update report
- an annual review following the end of the year describing the activity compared to the strategy (this report)

The regulatory environment places responsibility on members for the review and scrutiny of treasury management policy and activities. This report is, therefore, important in that respect, as it provides details of the outturn position for treasury activities and highlights compliance with the PCC's previously approved policies.

The PCC confirms that he has complied with the requirement under the Code to give prior scrutiny to all of the above treasury management reports by the Business Coordination Board before they were reported to the PCC.

2. The PCC's Capital Expenditure and Financing

The PCC undertakes capital expenditure on long-term assets. These activities may either be:

- Financed immediately through the application of capital or revenue resources (capital receipts, capital grants, revenue contributions etc.), which has no resultant impact on the PCC's borrowing need; or
- If insufficient financing is available, or a decision is taken not to apply resources, the capital expenditure will give rise to a borrowing need.

The actual capital expenditure forms one of the required prudential indicators. The table below shows the actual capital expenditure and how this was financed.

<i>£000's General Fund</i>	<i>2020/21 Actual</i>	<i>2021/22 Budget</i>	<i>2021/22 Actual</i>
Capital expenditure	4,812	21,360	7,802
Financed in year	4,314	10,028	6,043
Unfinanced capital expenditure	498	11,332	1,759

3. The PCC's Overall Borrowing Need

The PCC's underlying need to borrow to finance capital expenditure is termed the Capital Financing Requirement (CFR). This figure is a gauge of the PCC's indebtedness. The CFR results from the capital activity of the PCC and resources used to pay for the capital spend. It represents the 2021/22 unfinanced capital expenditure, and prior years' net or unfinanced capital expenditure which has not yet been paid for by revenue or other resources.

Part of the PCC's treasury activities is to address the funding requirements for this borrowing need. Depending on the capital expenditure programme, the treasury service organises the PCC's cash position to ensure that sufficient cash is available to meet the capital plans and cash flow requirements. This may be sourced through borrowing from external bodies, (such as the Government, through the Public Works Loan Board [PWLB], or the money markets), or utilising temporary cash resources within the PCC.

Reducing the CFR – the PCC's underlying borrowing need (CFR) is not allowed to rise indefinitely. Statutory controls are in place to ensure that capital assets are broadly charged to revenue over the life of the asset. The PCC is required to make an annual revenue charge, called the Minimum Revenue Provision (MRP), to reduce the CFR. This is effectively a repayment of the borrowing need. This differs from the treasury management arrangements which ensure that cash is available to meet capital commitments. External debt can also be borrowed or repaid at any time, but this does not change the CFR.

The total CFR can also be reduced by:

- the application of additional capital financing resources, (such as unapplied capital receipts); or
- charging more than the statutory revenue charge (MRP) each year through a Voluntary Revenue Provision (VRP).

The PCC's 2021/22 MRP Policy, (as required by DLUHC Guidance), was approved as part of the Treasury Management Strategy Report for 2021/22.

The PCC's CFR for the year is shown below and represents a key prudential indicator.

<i>CFR General Fund (£000's)</i>	<i>31 March 2021</i>	<i>31 March 2022</i>
	<i>Actual</i>	<i>Actual</i>
Opening Balance	22,206	21,982
Add unfinanced capital expenditure	498	1,759
Less MRP/VRP	(722)	(980)
Less PFI & finance lease repayments	-	-
Closing Balance	21,982	22,761

Gross borrowing and the CFR - in order to ensure that borrowing levels are prudent over the medium term and only for a capital purpose, the PCC should ensure that gross external borrowing does not, except in the short term, exceed the total of the capital financing requirement in the preceding year (2021/22) plus the estimates of any additional capital financing requirement for

the current (2022/23) and next two financial years. This essentially means that the PCC is not borrowing to support revenue expenditure. This indicator allowed the PCC some flexibility to borrow in advance of its immediate capital needs in 2021/22. The table below highlights the PCC's gross borrowing position against the CFR. The PCC has complied with this prudential indicator.

	<i>31 March 2021</i>	<i>31 March 2022</i>
	<i>Actual</i>	<i>Actual</i>
Gross Borrowing Position (£m)	17.3	16.7
CFR General Fund (£m)	22.0	22.8
(Under)/over funding of CFR (£m)	(4.7)	(6.1)

The authorised limit - the authorised limit is the “affordable borrowing limit” required by s3 of the Local Government Act 2003. Once this has been set, the PCC does not have the power to borrow above this level. The table below demonstrates that during 2021/22 the PCC has maintained gross borrowing within the authorised limit.

The operational boundary – the operational boundary is the expected borrowing position of the PCC during the year. Periods where the actual position is either below or over the boundary are acceptable subject to the authorised limit not being breached.

Actual financing costs as a proportion of net revenue stream - this indicator identifies the trend in the cost of capital, (borrowing and other long term obligation costs net of investment income), against the net revenue stream.

	<i>2021/22</i>
Authorised limit	£80.0m
Maximum gross borrowing position	£17.3m
Operational boundary	£69.6m
Average gross borrowing position	£17.0m
Financing costs as a proportion of net revenue stream	0.89%

4. Treasury Position as at 31 March 2022

At the beginning and the end of 2021/22 the PCC's treasury (excluding borrowing by PFI and finance leases) position was as follows:

<i>Treasury Position 2021/22 (£m'S)</i>	<i>31 March 2021 Principal</i>	<i>Rate/ Return</i>	<i>Average Life yrs</i>	<i>31 March 2022 Principal</i>	<i>Rate/ Return</i>	<i>Average Life yrs</i>
Total debt	17.3	3.38%	13.5	16.7	3.34%	12.5
CFR	22.0			22.6		
Over / (under) borrowing	(4.7)			(5.9)		
Total investments	14.4	0.06%		9.1	0.11%	
Net debt	2.9			7.6		

All investments within the portfolio were short term and liquidity remained the primary focus throughout the year. The structure of the investment portfolio comprised:

TREASURY PORTFOLIO				
	31 March 2021		31 March 2022	
Treasury Investments	£000	%	£000	%
Banks (UK)	14,380	100%	6,059	67%
Banks (Rest of World)	0	0%	3,000	33%
Local Authorities	0	0%	0	0%
DMADF (H.M. Treasury)	0	0%	0	0%
Money Market Funds	0	0%	0	0%
Certificates of Deposit	0	0%	0	0%
Total Managed In-house	14,380	100%	9,059	100%
Bond Funds	0	0%	0	0%
Property Funds	0	0%	0	0%
Total Managed Externally	0	0%	0	0%
Total Treasury Investments	14,380	100%	9,059	100%
Treasury External Borrowing				
Local Authorities	0	0%	0	0%
PWLB	17,301	100%	16,740	100%
Total External Borrowing	17,301	100%	16,740	100%
Net Treasury Investments / (Borrowing)	(2,921)		(7,681)	

5. The Strategy for 2021/22

5.1 Investment strategy and control of interest rate risk

Investment returns remained close to zero for much of 2021/22. Most local authority lending managed to avoid negative rates and one feature of the year was the continued growth of inter local authority lending. The expectation for interest rates within the treasury management strategy for 2021/22 was that Bank Rate would remain at 0.1% until it was clear to the Bank of England that the emergency level of rates introduced at the start of the Covid-19 pandemic were no longer necessitated.

The Bank of England and the Government also maintained various monetary and fiscal measures, supplying the banking system and the economy with massive amounts of cheap credit so that banks could help cash-starved businesses to survive the various lockdowns/negative impact on their cashflow. The Government also supplied huge amounts of finance to local authorities to pass on to businesses. This meant that for most of the year there was much more liquidity in financial markets than there was demand to borrow, with the consequent effect that investment earnings rates remained low until towards the turn of the year when inflation concerns indicated central banks, not just the Bank of England, would need to lift interest rates to combat the second-round effects of growing levels of inflation (CPI was 6.2% in February).

While the PCC has taken a cautious approach to investing, the PCC is also fully appreciative of changes to regulatory requirements for financial institutions in terms of additional capital and liquidity that came about in the aftermath of the financial crisis. These requirements have provided a far stronger basis for financial institutions, with annual stress tests by regulators evidencing how institutions are now far more able to cope with extreme stressed market and economic conditions.

Investment balances have been kept to a minimum through the agreed strategy of using reserves and balances to support internal borrowing, rather than borrowing externally from the financial markets. External borrowing would have incurred an additional cost, due to the differential between borrowing and investment rates as illustrated in the charts shown above and below. Such an approach has also provided benefits in terms of reducing counterparty risk exposure, by having fewer investments placed in the financial markets.

5.2 Borrowing strategy control of interest rate risk

During 2021/22, the PCC maintained an under-borrowed position. This meant that the capital borrowing need, (the Capital Financing Requirement), was not fully funded with loan debt, as cash supporting the PCC's reserves, balances and cash flow was used as an interim measure. This strategy was prudent as investment returns were low and minimising counterparty risk on placing investments also needed to be considered.

A cost of carry remained during the year on any new long-term borrowing that was not immediately used to finance capital expenditure, as it would have caused a temporary increase in cash balances; this would have incurred a revenue cost – the difference between (higher) borrowing costs and (lower) investment returns.

The policy of avoiding new borrowing by running down spare cash balances, has served well over the last few years. However, this was kept under review to avoid incurring higher borrowing costs in the future when the PCC may not be able to avoid new borrowing to finance capital expenditure and/or the refinancing of maturing debt.

Against this background and the risks within the economic forecast, caution was adopted with the treasury operations. The Director of Finance therefore monitored interest rates in financial markets and adopted a pragmatic strategy based upon the following principles to manage interest rate risks:

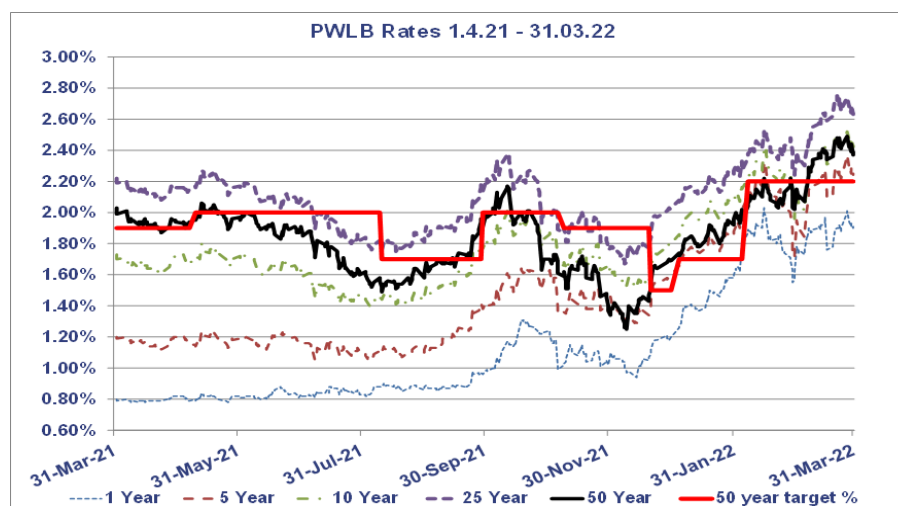
- if it had been felt that there was a significant risk of a sharp FALL in long and short term rates, (e.g. due to a marked increase of risks around relapse into recession or of risks of deflation), then long term borrowings would have been postponed, and potential rescheduling from fixed rate funding into short term borrowing would have been considered.
- if it had been felt that there was a significant risk of a much sharper RISE in long and short term rates than initially expected, perhaps arising from an acceleration in the start date and in the rate of increase in central rates in the USA and UK, an increase in world economic activity or a sudden increase in inflation risks, then the portfolio position would have been re-appraised. Most likely, fixed rate funding would have been drawn whilst interest rates were lower than they were projected to be in the next few years.

Interest rate forecasts expected only gradual rises in medium and longer term fixed borrowing rates during 2021/22 and the two subsequent financial years until the turn of the year, when inflation concerns increased significantly. Internal, variable, or short-term rates, were expected to be the cheaper form of borrowing until well in to the second half of 2021/22.

Forecasts at the time of approval of the treasury management strategy report for 2021/22 were as follows:

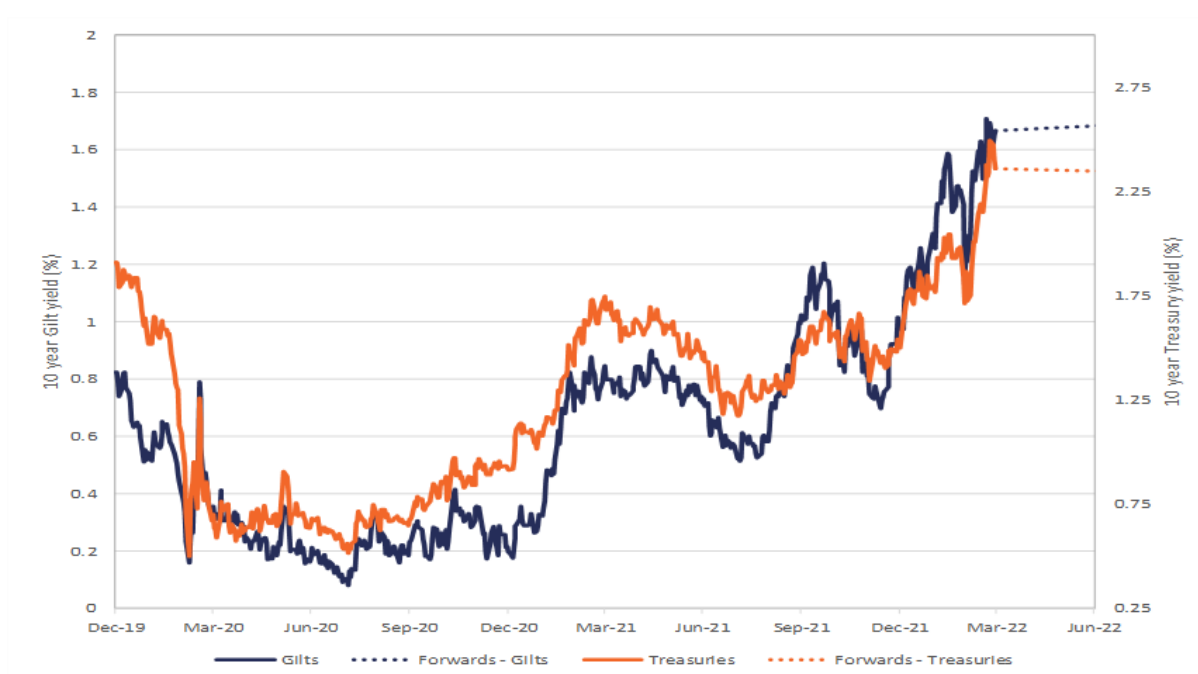
Link Group Interest Rate 8.3.21												
	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24
BANK RATE	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
3 month ave earnings	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
6 month ave earnings	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
12 month ave earnings	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20
5 yr PWLB	1.20	1.20	1.20	1.20	1.20	1.20	1.30	1.30	1.40	1.40	1.40	1.40
10 yr PWLB	1.60	1.60	1.60	1.70	1.70	1.70	1.80	1.80	1.90	1.90	1.90	1.90
25 yr PWLB	2.10	2.10	2.20	2.30	2.30	2.30	2.40	2.40	2.50	2.50	2.50	2.50
50 yr PWLB	1.90	1.90	2.00	2.10	2.10	2.10	2.20	2.20	2.30	2.30	2.30	2.30

PWLB Rates for 2021/22 are illustrated below.



PWLB rates are based on, and are determined by, gilt (UK Government bonds) yields through H.M.Treasury determining a specified margin to add to gilt yields. The main influences on gilt yields are Bank Rate, inflation expectations and movements in US treasury yields. Inflation targeting by the major central banks has been successful over the last 30 years in lowering inflation and the real equilibrium rate for central rates has fallen considerably due to the high level of borrowing by consumers: this means that central banks do not need to raise rates as much now to have a major impact on consumer spending, inflation, etc. This has pulled down the overall level of interest rates and bond yields in financial markets over the last 30 years. We have seen over the last two years, many bond yields up to 10 years in the Eurozone turn negative on expectations that the EU would struggle to get growth rates and inflation up from low levels. In addition, there has, at times, been an inversion of bond yields in the US whereby 10 year yields have fallen below shorter term yields. In the past, this has been a precursor of a recession. Recently, yields have risen since the turn of the year on the back of global inflation concerns.

Graph of UK gilt yields v. US treasury yields



Gilt yields fell sharply from the spring of 2021 through to September and then spiked back up before falling again through December. However, by January sentiment had well and truly changed, as markets became focussed on the embedded nature of inflation, spurred on by a broader opening of economies post the pandemic, and rising commodity and food prices resulting from the Russian invasion of Ukraine.

At the close of the day on 31 March 2022, all gilt yields from 1 to 5 years were between 1.11% – 1.45% while the 10-year and 25-year yields were at 1.63% and 1.84%.

Regarding PWLB borrowing rates, the various margins attributed to their pricing are as follows:

- **PWLB Standard Rate** is gilt plus 100 basis points (G+100bps)
- **PWLB Certainty Rate** is gilt plus 80 basis points (G+80bps)
- **PWLB HRA Standard Rate** is gilt plus 100 basis points (G+100bps)
- **PWLB HRA Certainty Rate** is gilt plus 80bps (G+80bps)

- **Local Infrastructure Rate** is gilt plus 60bps (G+60bps)

There is likely to be a further rise in short-dated gilt yields and PWLB rates over the next three years as Bank Rate is forecast to rise from 0.75% in March 2022 to 1.25% later this year, with upside risk likely if the economy proves resilient in the light of the cost-of-living squeeze. Medium to long dated yields are driven primarily by inflation concerns but the Bank of England is also embarking on a process of Quantitative Tightening when Bank Rate hits 1%, whereby the Bank's £895bn stock of gilt and corporate bonds will be sold back into the market over several years. The impact this policy will have on the market pricing of gilts, while issuance is markedly increasing, is an unknown at the time of writing.

6. Borrowing Outturn

Borrowing

Due to investment concerns, both counterparty risk and low investment returns, no further borrowing was undertaken during the year. Current loans held by the PCC are all with the Public Works Loan Board (PWLB) and total £16.7m as at 31 March 2022.

Borrowing in advance of need

The PCC has not borrowed more than, or in advance of its needs, purely in order to profit from the investment of the extra sums borrowed.

Rescheduling

No rescheduling was done during the year as the average 1% differential between PWLB new borrowing rates and premature repayment rates made rescheduling unviable.

7. Investment Outturn

Investment Policy

The PCC's investment policy is governed by Department for Levelling Up, Housing and Communities (DLUHC) guidance, which has been implemented in the annual investment strategy approved by the PCC. This policy sets out the approach for choosing investment counterparties, and is based on credit ratings provided by the three main credit rating agencies, supplemented by additional market data (such as rating outlooks, credit default swaps, bank share prices etc.).

The investment activity during the year conformed to the approved strategy, and the PCC had no liquidity difficulties.

Investments held by the PCC

The PCC maintained an average balance of £29.7m of internally managed funds. The internally managed funds earned £33,155 of interest, which equates to an average rate of return of 0.11%. The budget of £114,000 for interest was not met.

8. Conclusion

The security and liquidity of funds dominated investment decision making throughout the year as there was little hope of recovering interest when subdued rates prevailed the majority of the period. As the cash resources dwindle toward the end of the year there was little scope to take advantage of the uptick in rates available in the market.

Capital spend for the year was well below anticipated. With no further borrowing in-year the debt reduced in line with expectation.

9. Appendix 1: Prudential & Treasury Indicators

The following indicators are reporting requirements for Prudential and Treasury Indicators, as per the 2017 CIPFA Prudential Code for Capital Finance in Local Authorities and 2018 CIPFA Treasury Management in the Public Services Guidance Notes.

These indicators are designed for the reader to understand and evaluate the prudence and affordability of the PCC's capital expenditure plans and the borrowing and investment activities undertaken in support of this.

PRUDENTIAL INDICATORS

Capital Expenditure

This provides a summary of the PCC's capital expenditure. It reflects matters previously agreed and those proposed for the forthcoming financial periods.

Capital Expenditure		2020/21 Actual	2021/22 Actual	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate	2025/26 Estimate
Total Capital Expenditure	(A)	4,812	7,802	9,871	26,063	30,367	14,467
Financed by:							
Capital receipts		(537)	(1,551)	(4,025)	(3,275)	-	(11,027)
Revenue contribution		(2,073)	(4,307)	(3,840)	(3,440)	(3,440)	(3,440)
Grants and other contributions		(1,704)	(185)	(187)	-	-	-
Finance lease and PFI liabilities		-	-	-	-	-	-
Total Financing	(B)	(4,314)	(6,043)	(8,052)	(6,715)	(3,440)	(14,467)
Net financing need for year	(A)-(B)	498	1,759	1,819	19,348	26,927	-

Capital Financing Requirement (CFR)

The CFR shows the difference between the PCC's capital expenditure and the revenue or capital resources set aside to finance that spend. The CFR will increase where capital expenditure takes place and will reduce as the PCC makes Minimum Revenue Provision ("MRP") or Voluntary Revenue Provision ("VRP") or otherwise sets aside revenue or capital resources to finance expenditure.

Capital Financing Requirement	2020/21 Actual	2021/22 Actual	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate	2025/26 Estimate
Opening CFR	22,206	21,982	22,761	23,447	41,518	46,973
Capital spend	4,812	7,802	9,871	26,063	30,367	14,467
Resources used	(4,314)	(6,043)	(8,052)	(6,715)	(3,440)	(14,467)
MRP & VRP	(722)	(980)	(1,133)	(1,277)	(2,068)	(2,035)
Closing CFR	21,982	22,761	23,447	41,518	66,377	44,938

Authorised Limit

This represents a control on the maximum level of external debt the PCC can incur. The PCC has to show this aggregate amount split into the element in respect of actual external borrowing and that which relates to 'other long-term liabilities' - the latter being credit arrangements, as defined in statute and which will include the principle element of any finance lease or Private Finance Initiative obligations payable.

The Authorised Limit is a statutory limit determined under Section 3(1) of the Local Government Act 2003 for English and Welsh authorities, and for Scottish authorities under Regulation 6(1) of the Local Authority (Capital Finance and Accounting) (Scotland) Regulations 2016. The PCC has no legal power to borrow in excess of the limits set. Revision of this Indicator would need to be approved by the PCC in advance of any external debt taken on in excess of the limit then in force.

The Authorised Limit reflects a level of external debt that, whilst not desired, could be afforded by the PCC in the short-term, but which is not sustainable in the longer-term.

Authorised Limit	2020/21 Actual	2021/22 Actual	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate	2025/26 Estimate
Borrowing	41,254	79,802	51,711	83,286	83,767	70,716
Other Long Term Liabilities	200	200	200	200	200	200
Total Authorised Limit	41,454	80,002	51,911	83,486	83,967	70,916

The Operational Boundary

The Operational Boundary is the limit beyond which external debt is not normally expected to exceed. Again, the PCC is required to disclose an aggregate limit and separately disclose the element that relates to actual external borrowing and that which relates to other long-term liabilities. Unlike the Authorised Limit, the Operational Boundary is not an absolute limit but it reflects the PCC's expectations of the level at which external debt would not ordinarily be expected to exceed.

Operational Boundary	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26
	Actual	Actual	Estimate	Estimate	Estimate	Estimate
Borrowing	35,947	69,467	45,040	72,497	72,915	61,566
Other Long Term Liabilities	100	100	100	100	100	100
Total Operational Boundary	36,047	69,567	45,140	72,597	73,015	61,666

External Debt

The PCC has to disclose the closing balance for actual gross borrowing in respect of the financial period just ended, together with the level of other long-term liabilities and so the actual aggregate level of external debt at the Balance Sheet date. This clarifies the overall level of external debt, and allow comparison to the PCC's actual borrowing need as provided by the Gross debt and the CFR Indicator.

Actual External Debt as at 31st March	2021/22
	Actual
Borrowing	16,740
Other Long Term Liabilities	16
Total External Debt	16,756

Gross Debt and the Capital Financing Requirement

The PCC should only borrow to support a capital purpose, and borrowing should not be undertaken for revenue or speculative purposes. The PCC should ensure that gross debt does not, except in the short-term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for the three subsequent financial years. If the level of gross borrowing is below the PCC's capital borrowing need – the CFR – it demonstrates compliance with the requirement of this Indicator. The table shows an over-borrowed position in year 2025/26, this is due to a large loan forecasted in-year. The position the following year is expected to drop to less than £1m over-borrowed indicating a quick return to an under-borrowed position.

Gross Debt and the CFR	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26
	Actual	Actual	Estimate	Estimate	Estimate	Estimate
CFR	21,982	22,761	23,447	41,518	66,377	44,938
Gross Borrowing	17,325	16,756	19,161	37,493	61,511	60,107
Under/(Over) Borrowing	4,657	6,005	4,286	4,025	4,866	(15,169)

Ratio of Financing Costs

This Indicator shows the trend in the cost of capital (borrowing and other long-term obligation costs net of investment income) against the net revenue stream – i.e. taxation and non-specific grant income. The higher the ratio, the higher the proportion of resources tied up just to service net capital costs, and which represent a potential affordability risk.

Ratio of Financing Costs		2020/21	2021/22	2022/23	2023/24	2024/25	2025/26
		Actual	Actual	Estimate	Estimate	Estimate	Estimate
Interest cost on existing borrowing		604	579	553	526	526	526
Interest cost on new borrowing		-	-	70	514	1,091	1,074
Gains/losses on debt rescheduling		-	-	-	-	-	-
Interest and investment income		(114)	(114)	(114)	(114)	(114)	(114)
MRP & VRP		722	980	1,133	1,277	2,068	2,035
Total Financing Costs	(A)	1,212	1,445	1,642	2,203	3,571	3,521
Net Budget Requirement	(B)	152,467	161,654	171,431	178,286	184,037	188,916
Ratio of financing costs	(A)/(B)	0.79%	0.89%	0.96%	1.24%	1.94%	1.86%

TREASURY INDICATORS

Maturity Structure of Borrowing

The PCC is required to set gross limits on maturities for the periods shown and covers both fixed and variable rate borrowings. The reason being to try and control the PCC's exposure to large sums falling due for refinancing.

Maturity structure of borrowing:	Actual	Lower Limit	Upper Limit
Under 12 months	3%	0%	100%
12 to 24 months	4%	0%	100%
2 to 5 years	12%	0%	100%
5 to 10 years	18%	0%	100%
Over 10 years	63%	0%	100%

Limit for Principal Sums Invested for Longer Than a Year

This Indicator is seeking to support control of liquidity risk. The limits should be set with regard to the PCC's liquidity needs and reduce the potential need to have to make early exit from an investment in order to recover funds.

	Actual	Limit
Upper limit on total principal sums invested longer than a year	£ -	£ -
