

## Performance and Resources Scrutiny Programme 2023/24

Report to: the Office of the Police, Fire and Crime Commissioner for Essex

<b>Title of Report:</b>	<b>Treasury Management Outturn 2022/23</b>
<b>Classification:</b>	<b>Official</b>
<b>Agenda Number</b>	<b>3ii</b>
<b>Chief Officer</b>	<b>DCC Andrew Prophet</b>
<b>Report from:</b>	<b>Corporate Finance</b>
<b>Date of Meeting:</b>	<b>30<sup>th</sup> May 2023</b>
<b>Author on behalf of Chief Officer:</b>	<b>Arfanara Naidu, Technical Capital Accountant Matt Tokley, Head of Corporate Accounting</b>
<b>Date of Approval:</b>	<b>17<sup>th</sup> May 2023 - COG</b>

### 1.0 Purpose of Report

- 1.1 To present the annual treasury review/outturn report for 2022/23. The Chartered Institute of Public Finance and Accountancy (CIPFA) definition of treasury management is: 'The management of the organisation's 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.'

### 2.0 Recommendations

- 2.1 The PFCC is recommended to *formally note the treasury management outturn position for 2022/23.*

### 3.0 Executive Summary

- 3.1 This report provides an overview for how the PFCC's cash balances have been managed during 2022/23, whether there have been any deviations to the 2022/23 Treasury Management Strategy (TMS), and what investments and borrowings (where applicable) were undertaken during the year.

### 4.0 Introduction/Background

- 4.1 The PFCC 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 PFCC to approve a TMS before each financial year and to produce quarterly and annual treasury management outturn reports. This report fulfils the PFCC's legal obligation under the Local Government Act 2003 to have regard to the CIPFA Code.

- 4.2 As it stands the PFCC's Treasury Management Strategy (TMS) for 2023/24 is currently awaiting approval from the PFCC having previously been presented to the Strategic Board on the 1<sup>st</sup> March 2023, with a decision report currently pending sign-off. The CIPFA Prudential Code also includes a requirement for the PFCC to provide a Capital Strategy and Investment Strategy, documents which cover capital expenditure and financing, and non-treasury investments. In addition, the documents set out the approved thresholds for external borrowing for the upcoming financial year.
- 4.3 The PFCC has invested substantial 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 remains central to the PFCC's TMS. The approach to dealing with this risk is covered within the main body of the report.

## **5.0 External Context / Economic Background**

- 5.1 The war in Ukraine continued to keep the global inflation above the central bank's targets and the UK economic outlook remained relatively weak with chance of a mild recession. The economic backdrop during January to March 2023 continued to be influenced by the high energy and commodity prices, high inflation and the associated impact on household budgets and spending.
- 5.2 The base rate was 0.75% at the beginning of the reporting period with the Monetary Policy Committee (MPC) increasing the rates at every subsequent meeting throughout the year, with the Bank of England (BoE) increasing the rate to 4.25% in March 2023 due to continuing inflationary pressures. This has subsequently increased further to 4.50% in May 2023.
- 5.3 UK CPI was 5.5% in March 2022 but thereafter began to steadily increase. Initially driven by energy price effects and by inflation in sectors such as retail and hospitality which were re-opening after the pandemic lockdowns, inflation at this point was believed to be temporary. Thereafter price rises slowly became more widespread, as a combination of rising global costs and strong demand continued to be exacerbated by supply shortages and transport dislocations, also impacting the PFCC's capital programme. The surge in wholesale gas and electricity prices led to elevated inflation expectations. CPI for February 2023 was 10.4% year on year, up from 10.1% in January mainly due to increasing food prices and housing-related costs.
- 5.4 In respect of financial markets uncertainty continued to be a key driver of financial market sentiment and bond yields remained relatively volatile due to concerns over elevated inflation and higher interest, as well as the likelihood of the UK entering a recession and for how long the BoE would continue to tighten monetary policy.
- 5.5 Credit Default Swap (CDS) prices had been rising since the start of the period on the back of the invasion of Ukraine, and in the UK rose further in September/October 2022 at the time of the government's budget. After this, CDS prices had been falling, but the fallout from the Silicon Valley Bank collapse in March 2023 caused a spike on the back of the heightened uncertainty. They had moderated by the end of the period as fears of contagion subsided, but many are still above their pre-March levels reflecting that some uncertainty remains.

- 5.6 On the back of this, the PFCC's treasury advisor Arlingclose reduced its recommended maximum duration limit for unsecured deposits for all UK and Non-UK banks/institutions on its counterparty list to 35 days as a precautionary measure. No changes were made to the names on the list. As market volatility is expected to remain a feature, at least in the near term, the institutions and durations on the PFCC's counterparty list recommended by Arlingclose remains under constant review.

## 6.0 Current Work and Performance

- 6.1 On 31<sup>st</sup> March 2023, the PFCC had net investments of £0.97m (£14.22m, 31<sup>st</sup> March 2022) relating to income and expenditure from its revenue and capital activities. This is presented in Table 1 below.

Table 1: Balance Sheet Summary

	31st March 2022 Actual £m	31st March 2023 Actual £m	Movement £m
Capital financing requirement	16.12	17.03	0.90
Usable reserves	(32.85)	(28.90)	3.96
Working capital	2.51	10.90	8.39
<b>Net (borrowing)/investments</b>	<b>14.22</b>	<b>0.97</b>	<b>13.25</b>

- 6.2 Table 1 also refers to the Capital Financing Requirement (CFR) which represents the underlying need to borrow for capital purposes. Usable reserves and working capital are the underlying resources available for investment. It should be noted that the above figures reflect the Balance Sheet position at the time of writing and may be subject to further change pending completion of the 2022/23 unaudited Statement of Accounts process.
- 6.3 The treasury management cashbook position as at 31<sup>st</sup> March 2023 and the change over the twelve-month period is shown in Table 2 below.

Table 2: Treasury Management Summary

	31st March 2022 Actual £m	31st March 2023 Actual £m	Movement £m
Long/short-term external borrowing	0.00	0.00	0.00
<b>Total external borrowing</b>	<b>0.00</b>	<b>0.00</b>	<b>0.00</b>
Long-term investments	0.00	0.00	0.00
Short-term investments	10.00	0.00	(10.00)
Cash and cash equivalents	4.22	0.97	(3.25)
<b>Total investments</b>	<b>14.22</b>	<b>0.97</b>	<b>(13.25)</b>
<b>Total net investments</b>	<b>14.22</b>	<b>0.97</b>	<b>(13.25)</b>

Investments

- 6.4 The PFCC holds invested funds, representing income received in advance of expenditure plus balances and reserves held. During 2022/23 the PFCC's total cash and investment balance ranged between £0m and £50m due to differing profiles of income and expenditure. During this time there was one instance of short-term external borrowing required of £5m during April/May 2022 (see 6.15).
- 6.5 Both the CIPFA Code and government guidance require the PFCC to invest its funds prudently, and to have regard to the security and liquidity of its treasury investments before seeking the optimum rate of return, or yield. The PFCC's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving low investment income.
- 6.6 The table below summarises the actual investments held as at 31<sup>st</sup> March 2023 and the comparable figures for 31<sup>st</sup> March 2022 (excluding accrued interest and other adjustments). Please refer to Appendix A for full details of these investments.

Table 3: Investments

	31st March 2022 Actual £m	31st March 2023 Actual £m	Movement £m
Call accounts	3.26	2.51	(0.75)
Money market funds	3.30	1.60	(1.70)
Fixed term deposits (including notice accounts)	11.50	0.00	(11.50)
Lloyds current account	0.05	1.00	0.95
<b>Total</b>	<b>18.11</b>	<b>5.11</b>	<b>(13.00)</b>

- 6.7 The table below provides a reconciliation for the actual cash and investments held as at 31st March 2023 (as per Table 3) compared to those presented in the Treasury Management Summary (as per Table 2), the latter of which comprise the total 'Short-Term Investments' and 'Cash and Cash Equivalents' values recognised in the 2022/23 year-end PFCC/Group Balance Sheet position.

Table 4: Reconciliation of Investments to year-end Balance Sheet position

	31st March 2022 Actual £m	31st March 2023 Actual £m	Movement £m
Total actual investments held	18.11	5.11	(13.00)
Less: monies held on behalf of third parties (seizures under POCA, PACE and the Misuse of Drugs Act)	(4.02)	(4.13)	(0.12)
Add: petty cash advances/imprest	0.07	0.06	(0.01)
Less: unrepresented amounts for operational bank accounts	0.06	(0.07)	(0.13)
<b>Total cash &amp; cash equivalents and net investments (as per balance sheet)</b>	<b>14.22</b>	<b>0.97</b>	<b>(13.25)</b>

- 6.8 The above table incorporates elements of cashbook values from the Balance Sheet based on the accounting position at the 31<sup>st</sup> March. This includes unrepresented amounts for force bank accounts (the 2022/23 year-end position reflected a higher bank balance than recorded in the Balance Sheet, compared to the other way round at year-end 2021/22, both relating to timings issues in respect of when amounts were processed onto the financial system). In addition, third-party monies relating to seizures have also been deducted to arrive at the true force value of cash and investments held at year-end.
- 6.9 Overall, as shown in the opening row of Table 4, the actual investments decreased by just over £13m during 2022/23. Generally, levels of both payments and receipts increased over the twelve-month period when compared to the preceding year, 2021/22. In respect of payments, the main increase related to payroll costs for officers, staff and pensioners which increased by £19.1m (£239.8m in 2022/23, compared to £220.8m in 2021/22). This increase included the impact of additional Police Officers being recruited into the force and the related establishment growing, as well as pay inflation. Indirect employee costs relating to the HMRC, and Essex Pension Fund increased by £9.1m (£95.4m in 2021/22 compared to £104.5m in 2022/23). The increased value of supplier payments of £131.9m in 2022/23 compared to £129.9m in 2021/22 was comprised of revenue and capital commitments as well as additional payments to pensioners.
- 6.10 For receipts, the council tax rise in 2022/23 contributed revenue income of £144.3m (£129.9m in 2021/22), an increase of £9.9m. Other central sources of government funding as well as several significant grants (including a £2.5m special grant for Op Hazel) contributed to an increase in cashflow of £11m (£251.7m in 2022/23 compared to £241.9m in 2021/22). There was also a marginal increase in VAT reimbursements of £0.7m (£14.7m in 2022/23 compared to £13.9m in 2021/22). Other movements in income streams included a minor increase in other receipts of £0.7m in 2022/23 offset by a reduction in receipts from sale of property of £4.4m (income from property sales in 2021/22 was £5.1m compared to £0.6m in 2022/23). The latter reflected slippage due to some ongoing negotiations for sales of assets at the back end of 2022/23.

- 6.11 The average level of investments (excluding the element relating to third party monies) over the twelve-month period was £20.924m (£25.432m in 2021/22). Interest earnings for the period were £0.418m (£0.010m 2021/22), representing an average return of 2.00% (0.04% 2021/22) and a significant increase from the last couple of financial years as the PFCC benefitted from the more buoyant UK interest rate position, as the government hiked rates to attempt to combat the significant increase in inflation.
- 6.12 Money market funds (MMF's) and local authority deposits generally provided competitive returns compared to the Debt Management Account Deposit Facility (DMADF) where a significant amount of money was placed during the year. By the end of March 2023, the rates on DMADF deposits ranged between 4.05% and 4.15%. The return on MMF's used by the PFCC ranged between 4.00% to 4.11% as of 31<sup>st</sup> March 2023.
- 6.13 Due to the economic uncertainty during 2022/23, the PFCC's investment strategy was focused on liquidity and security, with MMF's and call accounts continuing to be the main instruments used in this regard. With favourable interest rates appearing in the short-term market and the BoE decision to increase the base rate to 1.25% during June 2022 a decision was made to purchase £5m of treasury bills in July for a duration of six months, achieving a 1.98% return, with a further £5m of bills purchased in September again for six months achieving 2.4% return.
- 6.14 The PFCC's chief objective when undertaking external borrowing is to either cover short-term cashflow deficits or, where applicable, fund longer-term investment. The main factors considered are to strike an appropriately minimal risk balance between securing low interest costs and achieving cost certainty over the period.
- 6.15 As of 31<sup>st</sup> March 2023, the PFCC held no long-term external borrowing, a position which is consistent with the previous financial period. The PFCC did however undertake external short-term borrowing of £5m with Manchester City Council during the first quarter of the year for a period of two weeks to maintain sufficient liquidity for treasury activities in line with the PFCC's TMS. Whilst it was expected that further external borrowing would potentially be required in 2022/23, the significant slippage reported in the capital programme and other income streams meant this was no longer required.
- 6.16 Based on current capital investment plans submitted as part of the approved 2023/24 budget, external borrowing is forecast for 2023/24 as well as the subsequent medium-term financial period, with the attributable values calculated by the 'liability benchmark' for the PFCC. Further detail of this will be set out within the 2023/24 TMS, however the external borrowing requirement will continue to be fundamentally linked to the progress of the capital programme and whether further slippage can be avoided going forward.

- 6.17 Whilst there was no external cash requirement during 2022/23 there was an increase in internal borrowing, due to a diminished amount of capital resources available to fund an annual capital programme which exceeded £8.5m in value in 2022/23. Internal borrowing relates to the accounting mechanism whereby the PFCC can choose to defer financing it is capital expenditure in the year and use its cash resources instead. This produces an increase in the CFR which is then reduced by Minimum Revenue Provision (MRP) being applied in subsequent years. For 2022/23 the closing CFR was £17.030m compared to £16.123m at the end of 2021/22. The net increase of £0.907m related to unfinanced 2022/23 capital expenditure of £1.697m, offset by £0.790m MRP being charged to revenue in the year.
- 6.18 Financing costs, comprising interest payable and MRP incurred in the year were budgeted at £0.866m, with the outturn position reflecting a £0.072m saving, mainly due to the interest budget of £0.069m only resulting in £0.001m of actual costs in the year.

## 7.0 Compliance

- 7.1 All treasury management activities undertaken during 2022/23 have complied with the CIPFA Code of Practice and the CIPFA Prudential Code, however, there have been some variations to the PFCC's approved TMS. The explanations for these issues are set out in the supporting paragraphs in the relevant section below.
- 7.2 **Gross Debt:** The PFCC is legally obliged to set an affordable external borrowing limit (also termed the authorised limit for external debt) each year. In line with statutory guidance a lower 'operational boundary' is also set as a warning level should external debt approach the affordable borrowing limit. This is calculated as the maximum level held at any one time during the financial year. Compliance with the authorised limit and operational boundary key prudential indicators in 2022/23 are shown in Table 5 below.

Table 5: Gross Debt Limits

	2022/23 - TMS	2022/23 - Actual	Complied (Yes/No)
Authorised limit - total external debt	£30m	£5m	Yes
Operational Boundary - total external debt	£20m	£5m	Yes

- 7.3 **Investment Counterparties:** Compliance with the approved investment counterparties list is shown in Table 6 below.

Table 6: Investment Counterparties

	2022/23 - maximum	31/03/2023	2022/23 guideline limit	Complied - 22/23 (Yes/No)
UK central government (including DMADF & Treasury Bills)	£30.0m	-	£ unlimited (10 years)	Yes
UK local government - per authority	£5.0m	-	£5.0m per authority (5 years)	Yes
Lloyds bank account plc (operational bank account) where credit rating is at least A	£2.9m (overnight only)	£1.00m / 19.55%	£2.0m (1 year), or up to £10.0m (overnight only)	Yes
UK financial institutions (between A and AAA, liquid investments with same day access)	£2.5m (maximum held for 1 x institution)	£2.51m (all institutions) / 49.13%	£5 per institution (unlimited)	Yes
Money market funds (AAA rated) - Total	£20.0m / 58%	£1.60m / 31.32%	50% of total investments	No* (see commentary below)

7.4 During the year there were five instances where money market funds (MMF's) exceeded the 50% threshold. This was on the 26<sup>th</sup> April at 51%, 27<sup>th</sup> May at 55%, 30<sup>th</sup> June at 55%, 28<sup>th</sup> August at 58% and 52% on the 15<sup>th</sup> March. These instances primarily related to additional cashflow movements after daily treasury activity had been completed, tipping the percentage over the guideline threshold. The 2023/24 TMS has now taken account of the practicalities of managing MMF's and the investment criteria has been amended as a result, meaning such issues are not expected to be a problem from 2023/24 onwards.

## 8.0 Treasury Management Indicators

- 8.1 The PFCC measured and managed its exposure to treasury management risks during 2022/23 using the following indicators.
- 8.2 **Interest rate exposure:** This indicator is set to control the PFCC's exposure to interest rate risk. The figures reflect the potential impact of a rise or decrease in the base rate by 1% with a potential adverse impact arising in each instance.

Table 7: Interest rate exposure

	2022/23 - TMS interest rate position	31/3/23 interest rate position	2022/23 forecast impact - max tolerance	2022/23 actual impact - max tolerance	Complied (Yes/No)
Upper limit on one year revenue impact of a 1% <u>rise</u> in interest rates	0.75%	4.25%	(200,000)	(114,000)	Yes
Upper limit on one year revenue impact of a 1% <u>fall</u> in interest rates			200,000	N/A	Yes (no rate decrease)



- 8.3 The indicator for interest rate rises is based upon the potential exposure to additional interest payable. The indicator for interest rate reductions is based upon the potential exposure to reduced levels of investment income.
- 8.4 **Security:** The PFCC has adopted a voluntary measure of its exposure to credit risk by using minimum credit rating criteria for the counterparties it invests money with. These credit ratings are provided by the three main credit agencies in the UK (Standard & Poors, Fitch and Moody's) and are used in addition to counterparty information received from the PFCC's treasury management advisors Arlingclose.

Table 8: Minimum credit ratings for counterparties

	31/3/23 actual	2022/23 target	Complied (Yes/No)
Minimum credit rating	A	A	Yes

- 8.5 **Liquidity:** The PFCC has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments on a daily basis, without the need for additional external borrowing. The amount available as well as the maximum amount utilised during 2022/23 is set out in Table 9 below.

Table 9: PFCC bank overdraft facility

	2022/23 target maximum usage	2022/23 actual maximum usage	Complied (Yes/No)
PFCC bank accounts	£1.0m (as per arranged facility)	£2.9m	No* (see below commentary)

- 8.6 The PFCC used the arranged overdraft position five times during 2022/23, three of which equated to a deficit of less than £1.0m. On two occasions the account was overdrawn on three consecutive days (over a weekend), £2.9m commencing 6<sup>th</sup> May and £1.1m commencing 1<sup>st</sup> July. In respect of the latter two occasions the overdrawn position was deemed to be preferable than arranging for a short-term external loan and these instances were also agreed with Lloyds in advance. For the 23/24 TMS the arranged overdraft facilities have been extended to £3m, which will assist in managing the PFCC's short-term cashflow shortages where required.
- 8.7 **Monies retained in same day access funds:** The PFCC seeks to keep a minimum amount of money in call accounts and money market funds to ensure it is fully able to meet unforeseen commitments as they arise. The guideline criteria and actual position in 2022/23 are shown in Table 10 below:

Table 10: Monies retained in same day access funds

	2022/23 target	Complied (Yes/No)
Minimum amount of investment portfolio held in call accounts and money market funds	Lower of £10m or 50% of total investments	No

- 8.8 This indicator has not been met due to the amount of instances during the year where the PFCC held small amounts of cash and investments, and had amounts tied up in fixed-term investments during some of these occasions. This indicator will continue to be reviewed during 2023/24 to see ascertain whether it is still realistic and/or whether the target needs to be amended. The focus on liquidity continues to be a PFCC priority in respect of its cash management.
- 8.9 **Principal sums invested beyond 365 days:** The purpose of this indicator is to control the PFCC's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the total principal sum invested to final maturities longer than one year are shown in Table 11 below:

Table 11: Investments longer than one year

	2022/23 actual	2022/23 target	Complied (Yes/No)
Principal invested beyond one year in duration	£0.0m	£5.0m	Yes

- 8.10. All investments were kept short-term during 2022/23 with a maximum investment duration of six months, relating to local authority deposits. This was due to revised investment advice received from Arlingclose, which subsequently led to the removal of fixed term deposits for periods greater than 365 days in the 2023/24 TMS.
- 8.11 **Maturity structure of borrowing:** This indicator is set to control the PFCC's exposure to refinancing risk. The upper and lower limits on the maturity structure of external borrowing were set out in the 2022/23 TMS with various thresholds for differing time period. As the PFCC only had one instance of external borrowing during the year and this was for two weeks only, this fell into the 'less than 12 months bracket' for which a 100% threshold applied. The PFCC therefore complied with this indicator.

## 9.0 Consultation/Engagement

- 9.1 Elements of this paper have been prepared in consultation with Arlingclose, the PFCC's treasury management advisors.

## Investments position on 31st March 2022

	31/03/2022	Start date	Maturity date	Approx. Rate
	£000			%
<b>Call/notice accounts</b>				
Santander UK PLC	2,260			0.02%
Barclays Bank FIBCA	1,000			0.00%
Barclays Bank PLC	1,500			0.05%
<b>Total</b>	<b>4,760</b>			
<b>Money market funds</b>				
Blackrock	2,800			0.05%
Insight	500			0.00%
<b>Total</b>	<b>3,300</b>			
<b>Fixed term deposits / Treasury Bills</b>				
Treasury Bills Bank of England	4,999	22/11/2021	23/05/2022	0.05%
Thurrock Council	5,000	15/10/2021	19/04/2022	0.10%
<b>Total</b>	<b>9,999</b>			
<b>Other</b>				
Lloyds current account	48			0.02%
	<b>48</b>			
<b>Total treasury investments</b>	<b>18,107</b>			

## Investments position on 31st March 2023

	31/03/2023	Start date	Maturity date	Approx. Rate
	£000			%
<b>Call/notice accounts</b>				
Santander UK PLC	10			3.00%
Barclays Bank FIBCA	2,500			3.25%
<b>Total</b>	<b>2,510</b>			
<b>Money market funds</b>				
Insight	100			4.11%
Federated	1,000			4.09%
Aviva	500			4.11%
<b>Total</b>	<b>1,600</b>			
<b>Other</b>				
Lloyds current account	999			2.50%
	<b>999</b>			
<b>Total treasury investments</b>	<b>5,109</b>			