WEST MIDLANDS FIRE AND RESCUE AUTHORITY

AUDIT COMMITTEE

10 SEPTEMBER 2012

1. TREASURY MANAGEMENT ANNUAL REPORT 2011/12

Joint report of the Chief Fire Officer and Treasurer.

RECOMMENDED

THAT the report and Appendix are noted and the prudential and treasury indicators approved.

2. PURPOSE OF REPORT

2.1 The Authority agreed its 2011/12 Treasury Management Strategy Statement & Annual Investment Strategy and its Prudential Indicators in February 2011. Part of the requirements of the Treasury Strategy and Prudential Code are that periodic reports are presented to Members.

2.2 The annual treasury report covers the treasury activity during 2011/12 and the actual Prudential Indicators for 2011/12.

3. BACKGROUND

3.1 The Authority is required to produce an annual treasury management report of activities and the actual prudential and treasury indicators for 2011/12.

3.2 Appendix 1, the Annual Treasury Management Report 2011/12 meets the requirement of both the CIPFA Code of Practice on Treasury Management (the Code) and the CIPFA Prudential Code of Capital Finance in Local Authorities (the Prudential Code). The Authority is required to comply with both Codes through regulation issued under the Local Government Act 2003.

4. **EQUALITY IMPACT ASSESSMENT**

In preparing this report, an initial Equality Impact Assessment is not required and has not been carried out because the matters contained in this report do not relate to a policy change.

5. **LEGAL IMPLICATIONS**

The course of action recommended in this report does not raise issues which should be drawn to the attention of the Authority's Monitoring Officer.

6. **FINANCIAL IMPLICATIONS**

These are contained in the body of the report and the attached Appendix.

BACKGROUND PAPERS

Authority's Budget and Precept Report – February 2011
Quarterly Treasury Management Reports (Sandwell MBC)

V. RANDENIYA	S. KELLAS
CHIEF FIRE OFFICER	TREASURER

APPENDIX 1

WEST MIDLANDS FIRE SERVICE

Annual Treasury Management Report 2011/12

Ref: AU/AC/82507121

1. Introduction

This Authority 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 2011/12. 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).

During 2011/12 the minimum reporting requirements were that Members should receive the following reports:

- an annual treasury strategy in advance of the year (Authority 14/02/2011)
- a mid year treasury update report (Audit and Performance Management Committee 28/11/2011)
- an annual review following the end of the year describing the activity compared to the strategy (this report)

This report provides details of the outturn position for treasury activities and highlights compliance with the Authority's policies previously approved by Members.

During 2011/12, the Authority complied with its legislative and regulatory requirements. The key actual prudential and treasury indicators detailing the impact of capital expenditure activities during the year, with comparators, are as follows:

Actual Prudential and Treasury Indicators	**2010/11**	**2011/12**
Actual Capital Expenditure	£3.477m	£3.658m
Total Capital Financing Requirement	£54.540m	£52.428m
Financing Costs to Net Revenue Stream	4.30%	4.30%

The Treasurer confirms that no borrowing was undertaken for any capital purpose during 2011/12 and that the statutory borrowing limit (the authorised limit), was not breached.

As at 31st March 2012, the Authority's external debt was £44.644m (£45.430m as at 31st March 2011) and its investment totalled £33.2m (£34.2m as at 31st March 2011).

2. The Economy and Interest Rates

The financial year 2011/12 continued the challenging investment environment of previous years, namely low investment returns and continuing heightened levels of counterparty risk. The original expectation for 2011/12 was that Bank Rate would start gently rising from quarter 4 2011. However, GDP growth in the UK was disappointing during the year under the weight of the UK austerity programme, a lack of rebalancing of the UK economy to exporting and weak growth in our biggest export market - the EU. The EU sovereign debt crisis grew in intensity during the year until February when a second bailout package was eventually agreed for Greece. Weak UK growth resulted in the Monetary Policy Committee increasing quantitative easing by £75bn in October and another £50bn in February. Bank Rate therefore ended the year unchanged at 0.5% while CPI inflation peaked in September at 5.2% but then fell to 3.4% in February, with further falls expected to below 2% over the next two years.

Gilt yields fell for much of the year, until February, as concerns continued building over the EU debt crisis. This resulted in safe haven flows into UK gilts which, together with the two UK packages of quantitative easing during the year, combined to depress PWLB rates to historically low levels.

Investment rates. Risk premiums were also a constant factor in raising money market deposit rates for periods longer than 1 month. Widespread and multiple downgrades of the ratings of many banks and sovereigns, continued Eurozone concerns, and the significant funding issues still faced by many financial institutions, meant that investors remained cautious of longer-term commitment.

3. The Authority's Capital Expenditure and Financing

The Authority 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 Authority'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.

	2010/11 Actual £m	**2011/12 Actual £m**
Total Capital Expenditure	3.477	3.658
Resourced by:		
• Capital Receipts	0	0
• Capital Grants	1.629	2.996
• Revenue Contribution to Capital	1.848	662
Capital Expenditure Financed from Borrowing	0	0

4. The Authority's overall borrowing need

The Authority's underlying need to borrow for capital expenditure is termed the Capital Financing Requirement (CFR). This figure is a gauge of the Authority's debt position. The CFR results from the capital activity of the Authority and what resources have been used to pay for the capital spend. It represents the 2011/12 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 Authority's treasury activities is to address the funding requirements for any borrowing need. Depending on the capital expenditure programme, the treasury service at Sandwell MBC organise its own and the Authority's cash position via a pooling arrangement of bank accounts to ensure 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.

Reducing the CFR – the Authority'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 Authority 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 Authority's Treasury Management Strategy Report for 2011/12 was approved on 14th February 2011.

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

CFR	**31 March 2011 Actual £'000**	**31 March 2012 Actual £'000**
Opening balance	52,352	54,540
Add unfinanced capital expenditure	0	0
Supported Borrowing not undertaken	4,559	0
Less MRP/VRP	(2,371)	(2,112)
Closing balance	54,540	52,428

5. Treasury Position as at 31st March 2012

In 2010/11 the Authority did not operate its own loans pool and loans required to fund capital expenditure were advanced from Sandwell MBC. During 2011/12 the Authority has established its own portfolio of loans payable directly to the Public Works Loan Board (PWLB). Loans are also outstanding to Dudley MBC, these represent the Authority's share of the outstanding loan debt of the West Midlands County Council (WMCC) abolished in 1986.

The Authority's investment position is organised with the treasury management service at Sandwell MBC with whom a pooling of bank accounts arrangement exists in order to ensure adequate liquidity for revenue and capital activities, security for investments and to manage risks within all treasury management activities.

Procedures and controls to achieve these objectives are well established both through Member reporting, and through officer activity detailed in the Authority's Treasury Management Practices.

At the beginning and the end of 2011/12 the Authority's treasury position was as follows:

	31 March 2011 Principal	Rate/ Return	31 March 2012 Principal	Rate/ Return
Fixed Rate Loans:				
Sandwell MBC	*£41.0m*	*6.1%*		
PWLB			*£40.3m*	*6.0%*
Ex WMCC	*£4.5m*	*6.6%*	*£4.4m*	*6.6%*
Total Debt	***£45.5m***	***6.2%***	***£44.7m***	***6.1%***
CFR	***£54.5m***		***£52.4m***	
Over / (under) borrowing	***(£9.0m)***		***(£7.7m)***	
Investments:				
Sandwell MBC	***£34.2m***	***1.0%***	***£33.2m***	***0.9%***
Net Debt	**£11.3m**		**£11.5m**	

6. Prudential Indicators and Compliance Issues

During 2011/12, the Authority complied with its legislative and regulatory requirements. The key actual prudential and treasury indicators detailing the impact of capital expenditure activities during the year, with comparators, are as follows:

Actual Prudential and Treasury Indicators	2010/11 Actual £m	2011/12 Actual £m
Capital Expenditure	3.477	3.658
Capital Financing Requirement	54.540	52.428
External Debt	45.430	44.644
Investments	34.207	33.194
Net Borrowing	11.223	11.450

Net borrowing and the CFR - in order to ensure that borrowing levels are prudent over the medium term the Authority's external borrowing, net of investments, must only be for a capital purpose. This essentially means that the Authority is not borrowing to support revenue expenditure. Net borrowing should not therefore, except in the short term, have exceeded the CFR for 2011/12 plus the expected changes to the CFR over 2011/12 and 2012/13 from financing the capital programme. This indicator allows the Authority some flexibility to borrow in advance of its immediate capital needs in 2011/12.

The authorised limit - the authorised limit is the "affordable borrowing limit" required by s3 of the Local Government Act 2003. The Authority does not have the power to borrow above this level. The table below demonstrates that during 2011/12 the Authority has maintained gross borrowing within its authorised limit.

The operational boundary – the operational boundary is the expected borrowing position of the Authority during the year. Periods where the actual position is either below or over the boundary is 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.

	2010/11	2011/12
Authorised limit	£66m	£63m
Operational boundary	£60m	£58m
Maximum gross borrowing position	£46m	£45m
Financing costs as a proportion of net revenue stream	4.30%	4.30%

The maturity structure of the debt portfolio was as follows:

	31 March 2012 Actual
Under 12 months	£1.422m
12 months and within 24 months	£1.437m
24 months and within 5 years	£3.157m
5 years and within 10 years	£7.093m
10 years and above	£31.535m

7. The Strategy for 2011/12

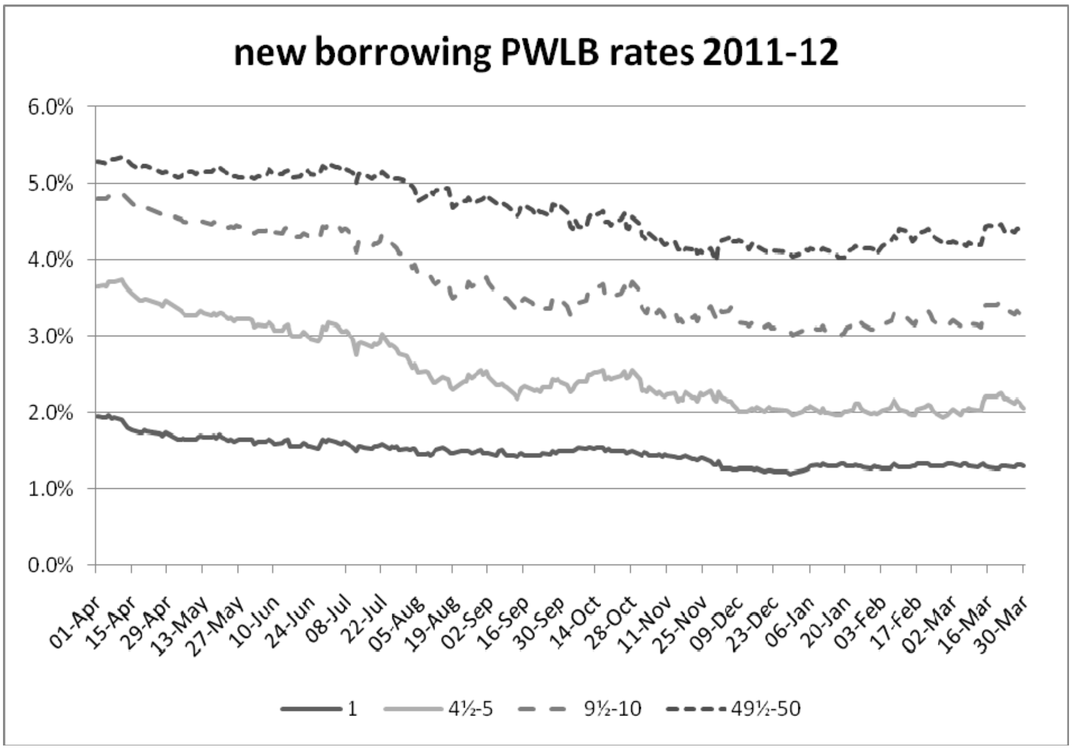
The expectation for interest rates within the strategy for 2011/12 anticipated low but rising Bank Rate (starting in quarter 4 of 2011) with similar gradual rises in medium and longer term fixed borrowing rates over 2011/12. Variable or short-term rates were expected to be the cheaper form of borrowing over the period. Continued uncertainty in the aftermath of the 2008 financial crisis promoted a cautious approach, whereby investments would continue to be dominated by low counterparty risk considerations, resulting in relatively low returns compared to borrowing rates.

In this scenario, the treasury strategy was to postpone borrowing to avoid the cost of holding higher levels of investments and to reduce counterparty risk.

The actual movement in gilt yields meant PWLB rates fell sharply during the year and to historically low levels. This was caused by a flight to quality into UK gilts from EU sovereign debt and also from shares as investors became very concerned about the potential for a Lehmans type meltdown of financial markets if the Greek debt crisis were to develop into a precipitous default and exit from the Euro.

8. Borrowing Rates in 2011/12

PWLB borrowing rates - the graph below shows PWLB rates during the year.



9. Borrowing Outturn for 2011/12

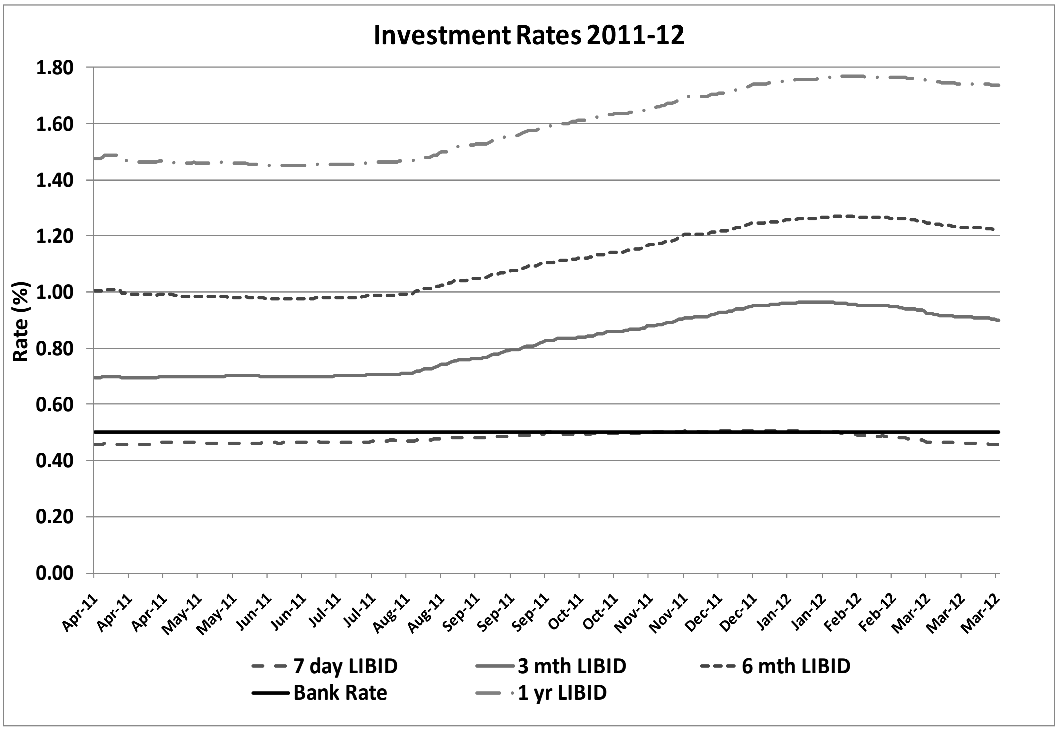
Borrowing – No Borrowing was undertaken during 2011/12.

Rescheduling –No rescheduling was undertaken during 2011/12.

10. Investment Rates in 2011/12

The tight monetary conditions following the 2008 financial crisis continued through 2011/12 with little material movement in the shorter term deposit rates. However, one month and longer rates rose in the second half of the year as the Eurozone crisis grew. Bank Rate remained at its historic low of 0.5% throughout the year while market expectations of the imminence of monetary tightening were gradually pushed further and further back during the year to the second half of 2013 at the earliest.

Overlaying the relatively poor investment returns were the continued counterparty concerns generated by the Eurozone sovereign debt crisis.



11. Investment Outturn for 2011/12

Investment Policy – the Authority's investment policy is governed by CLG guidance, which was been implemented in the Annual Investment Strategy approved by the Authority on 14th February 2011. The investment activity during the year conformed to the approved strategy, and the Authority had no liquidity difficulties.

Investments held by the Authority - the Authority maintained an average balance of £37.3m of internally managed funds. The internally managed funds earned an average rate of return of 0.88%. The comparable performance indicator is the average 7-day LIBID rate which was 0.48%. This compares with a budget assumption of £35m investment balances earning an average rate of 0.575%.