APPENDIX A

WEST MIDLANDS FIRE SERVICE

Annual Treasury Management Review
2018/19

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 2018/19. 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 2018/19 the minimum reporting requirements were that the Authority should receive the following reports:

- an annual treasury strategy in advance of the year (Authority 19/02/2018)
- a mid-year treasury update report (Audit Committee 12/11/2018)
- 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 2018/19 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	2017/18	2018/19
Actual capital expenditure	£4.527m	£8.890m
Total Capital Financing Requirement	£37.977m	£37.143m
Financing costs to net revenue stream	2.7%	2.4%

The Treasurer confirms that no borrowing was undertaken for any capital purpose during 2018/19 and that the statutory borrowing limit (the authorised limit), was not breached.

As at 31st March 2019, the Authority's external debt was £36.002m (£37.363m as at 31st March 2018) and its investment totalled £40.904m (£51.905m as at 31st March 2018).

2. The Economy and Interest Rates

UK. After weak economic growth of only 0.2% in quarter one of 2018, growth picked up to 0.4% in quarter 2 and to a particularly strong 0.7% in quarter 3, before cooling off to 0.2% in the final quarter. Given all the uncertainties over Brexit, this weak growth in the final quarter was as to be expected. However, some recovery in the rate of growth is expected going forward. The annual growth in Q4 came in at 1.4% year-over-year confirming that the UK was the third fastest growing country in the G7 in quarter 4.

After the Monetary Policy Committee raised Bank Rate from 0.5% to 0.75% in August 2018, it is little surprise that they have abstained from any further increases since then. We are unlikely to see any further action from the MPC until the uncertainties over Brexit clear. If there were a disorderly exit, it is likely that Bank Rate would be cut to support growth. Nevertheless, the MPC has been having increasing concerns over the trend in wage inflation which peaked at a new post financial crisis high of 3.5%, (excluding bonuses), in the three months to December before falling only marginally to 3.4% in the three months to January. British employers ramped up their hiring at the fastest pace in more than three years in the three months to January as the country's labour market defied the broader weakness in the overall economy as Brexit approached. The number of people in work surged by 222,000, helping to push down the unemployment rate to 3.9 percent, its lowest rate since 1975. Correspondingly, the total level of vacancies has risen to new highs.

As for CPI inflation itself, this has been on a falling trend since peaking at 3.1% in November 2017, reaching a new low of 1.8% in January 2019 before rising marginally to 1.9% in February. However, in the February 2019 Bank of England Inflation Report, the latest forecast for inflation over both the two and three year time horizons remained marginally above the MPC's target of 2%.

The rise in wage inflation and fall in CPI inflation is good news for consumers as their spending power is improving in this scenario as the difference between the two figures is now around 1.5%, i.e. a real terms increase. Given the UK economy is very much services sector driven, an increase in household spending power is likely to feed through into providing some support to the overall rate of economic growth in the coming months.

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.

	2017/18 Actual £m	2018/19 Actual £m
Total capital expenditure	**4.527**	**8.809**
Resourced by:		
• Capital receipts	0.000	0.000
• Capital grants	0.173	0.660
• Revenue Contribution to Capital	4.354	8.149
Capital Expenditure Financed from Borrowing	**0**	**0**

4. Overall Treasury Position as at 31 March 2019

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 2018/19 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 this borrowing need. Depending on the capital expenditure programme, the treasury service organises the Authority'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.

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);
- charging more than the statutory revenue charge (MRP) each year through a Voluntary Revenue Provision (VRP).

The Authority's Treasury Management Strategy Report for 2018/19 was approved 19 February 2018.

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

CFR	31 March 2018 Actual £m	31 March 2019 Actual £m
Opening balance	38.764	37.977
Add unfinanced capital expenditure	0	0
Less MRP	(0.787)	(0.834)
Less VRP	0	0
Closing balance	37.977	37.143

Borrowing activity is constrained by prudential indicators for gross borrowing and the CFR, and by the authorised limit.

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 Authority should ensure that its gross external borrowing does not, except in the short term, exceed the total of the capital financing requirement in the preceding year (2018/19) plus the estimates of any additional capital financing requirement for the current (2018/19) and next two financial years. This essentially means that the Authority is not borrowing to support revenue expenditure. This indicator allows the Authority some flexibility to borrow in advance of its immediate capital needs in 2018/19.

	31 March 2017 Actual £m	31 March 2018 Actual £m
External Debt	37.363	36.002
Investments	51.905	40.904
Net Borrowing Position	(14.542)	(4.902)
CFR	37.977	37.143

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 2018/19 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.

	2017/18	2018/19
Authorised limit	£46m	£45m
Operational boundary	£42m	£41m
Maximum gross borrowing position	£39m	£38m
Financing costs as a proportion of net revenue stream	2.7%	2.4%

5. Overall Treasury Position as at 31 March 2019

The Authority's investment position is organised with the treasury management service at Sandwell MBC, 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 2018/19 the Authority's position was as follows:

	31 March 2018 Principal £m	Rate/ Return	31 March 2019 Principal £m	Rate/ Return
Fixed Rate Loans:				
PWLB	*£34.2*	*5.4%*	*£33.1*	*5.3%*
Ex WMCC	*£3.2*	*6.1%*	*£2.9*	*5.6%*
Total Debt	*£37.4*	*5.5%*	*£36.0*	*5.4%*
CFR	*£38.0*		*£37.1*	
Over / (under) borrowing	*(£0.6)*		*(£1.1)*	
Investments:				
Sandwell MBC	*£51.9*	*0.4%*	*£40.9*	*0.7%*
Net Debt	(£14.5)		(£4.9)	

The maturity structure of the debt portfolio was as follows:

	31 March 2018 Actual £m	31 March 2019 Actual £m
Under 12 months	1,361	305
12 months and within 24 months	305	2.022
24 months and within 5 years	4,990	3,836
5 years and within 10 years	4,007	3,139
10 years and above	26,700	26,700

6. The Strategy for 2018/19

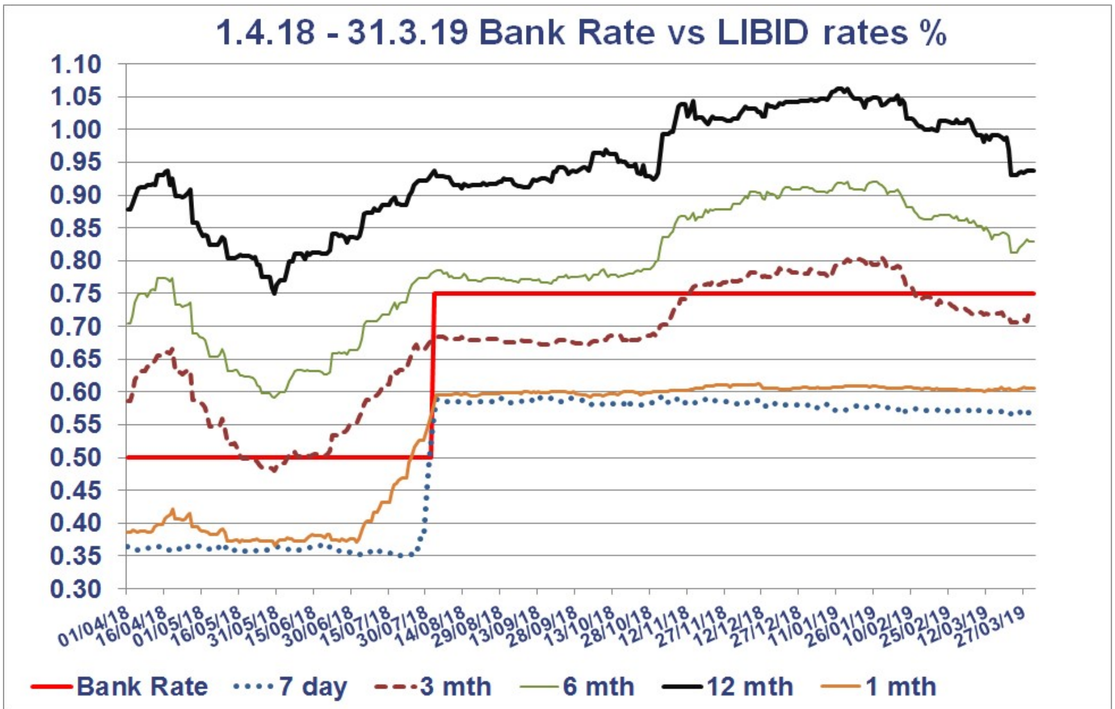
Investment returns remained low during 2018/19. The expectation for interest rates within the treasury management strategy for 2018/19 was that Bank Rate would rise from 0.50% to 0.75%. At the start of 2018-19, and after UK GDP growth had proved disappointingly weak in the first few months of 2018, the expectation for the timing of this increase was pushed back from May to August 2018. Investment interest rates were therefore on a gently rising trend in the first half of the year after April, in anticipation that the MPC would raise Bank Rate in August. This duly happened at the MPC meeting on 2 August 2018. During this period, investments were, therefore, kept shorter term in anticipation that rates would be higher later in the year.

It was not expected that the MPC would raise Bank Rate again during 2018-19 after August in view of the fact that the UK was entering into a time of major uncertainty with Brexit due in March 2019. Value was therefore sought by placing longer term investments after 2 August where cash balances were sufficient to allow this.

Investment rates were little changed during August to October but rose sharply after the MPC meeting of 1 November was unexpectedly hawkish about their perception of building inflationary pressures, particularly from rising wages. However, weak GDP growth data after December, plus increasing concerns generated by Brexit, resulted in investment rates falling back again.

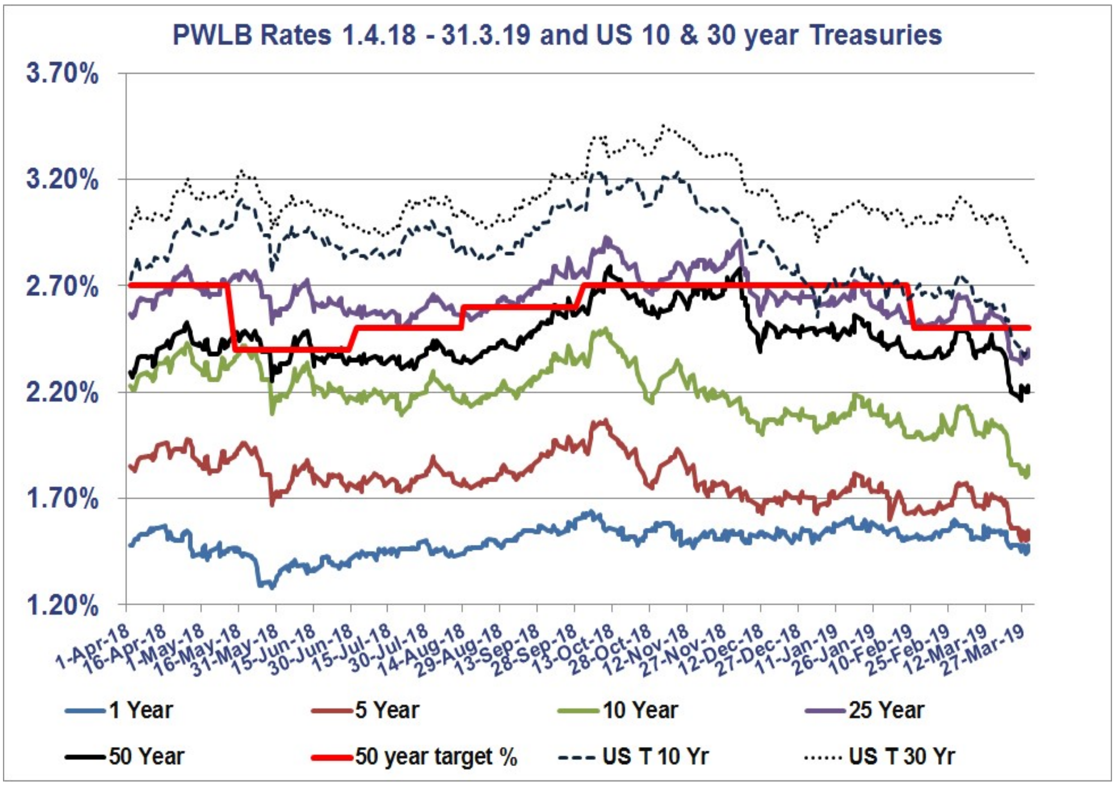
Continued uncertainty in the aftermath of the 2008 financial crisis has promoted a cautious approach whereby investments would continue to be dominated by low counterparty risk considerations, resulting in relatively low returns compared to borrowing rates.

Investment strategy and control of interest rate risk



7. Borrowing Rates in 2018/19

The graphs for PWLB rates show, for a selection of maturity periods, the average borrowing rates, the high and low points in rates, spreads and individual rates at the start and the end of the financial year.



8. Borrowing Outturn for 2018/19

Borrowing – No borrowing was undertaken during 2018/19.

Rescheduling – No rescheduling was undertaken during 2018/19.

9. Investment Outturn for 2018/19

Investment Policy – the Authority's investment policy is governed by MHCLG guidance, which was been implemented in the annual investment strategy approved by the Authority on 19th February 2018. 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 Authority had no liquidity difficulties.

Investments held by the Authority - the Authority maintained an average balance of £56.7m of internally managed funds. The internally managed funds earned an average rate of return of 0.73%. The comparable performance indicator is the average 7-day LIBID rate, which was 0.51%. This compares with a budget assumption of £50m investment balances earning an average rate of 0.77%.