APPENDIX 1

WEST MIDLANDS FIRE SERVICE

Treasury Management Strategy Statement and Annual Investment Strategy

Mid-year Review Report 2014/15

1. Background

The Authority operates a balanced budget, which broadly means cash raised during the year will meet its cash expenditure. Part of the treasury management operations ensure this cash flow is adequately planned, with surplus monies being invested in low risk counterparties, providing adequate liquidity initially before considering maximising investment return.

The second main function of the treasury management service is the funding of the Authority's capital plans. These capital plans provide a guide to the borrowing need of the Authority, essentially the longer term cash flow planning to ensure the Authority can meet its capital spending operations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses, and on occasion any debt previously drawn may be restructured to meet Authority risk or cost objectives.

As a consequence treasury management is defined as:

"The management of the local authority's investments and 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. Introduction

The Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management 2011 has been adopted by this Authority.

The primary requirements of the Code are as follows:

1. Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Authority's treasury management activities.

2. Creation and maintenance of Treasury Management Practices which set out the manner in which the Authority will seek to achieve those policies and objectives.

3. Receipt by the full Authority of an annual Treasury Management Strategy Statement - including the Annual Investment Strategy and Minimum Revenue Provision Policy - for the year ahead, a Mid-year Review Report and an Annual Report covering activities during the previous year.

4. Delegation by the Authority of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.

5. Delegation by the Authority of the role of scrutiny of treasury management strategy and policies to a specific named body. For this Authority the delegated body is the Audit Committee.

This mid-year report has been prepared in compliance with CIPFA's Code of Practice on Treasury Management, and covers the following:

- An economic update for the first six months of 2014/15;
- A review of the Treasury Management Strategy Statement and Annual Investment Strategy;
- The Authority's capital expenditure (prudential indicators);
- A review of the Authority's investment portfolio for 2014/15;
- A review of the Authority's borrowing strategy for 2014/15;
- A review of any debt rescheduling undertaken during 2014/15;
- A review of compliance with Treasury and Prudential Limits for 2014/15.

3. Economic update

3.1 Economic performance to date and outlook

3.1.1 U.K.

After strong UK GDP quarterly growth of 0.7%, 0.8% and 0.7% in quarters 2, 3 and 4 respectively in 2013, and 0.7% in Q1 and 0.9% in Q2 2014, it appears very likely that strong growth will continue through 2014 and into 2015 as forward surveys for the services and construction sectors, are very encouraging and business investment is also strongly recovering. The manufacturing sector has also been encouraging though the latest figures indicate a weakening in the future trend rate of growth. However, for this recovery to become more balanced and sustainable in the longer term, the recovery needs to move away from dependence on consumer expenditure and the housing market to exporting, and particularly of manufactured goods, both of which need to substantially improve on their recent lacklustre performance. This overall strong growth has resulted in unemployment falling much faster through the initial threshold of 7%, set by the Monetary Policy Committee (MPC) last August, before it said it would consider any increases in Bank Rate. The MPC has, therefore, subsequently broadened its forward guidance by adopting five qualitative principles and looking at a much wider range of about eighteen indicators in order to form a view on how much slack there is in the economy and how quickly slack is being used up. The MPC is particularly concerned that the current squeeze on the disposable incomes of consumers should be reversed by wage inflation rising back above the level of inflation in order to ensure that the recovery will be sustainable. There also needs to be a major improvement in labour productivity, which has languished

at dismal levels since 2008, to support increases in pay rates. Most economic forecasters are expecting growth to peak in 2014 and then to ease off a little, though still remaining strong, in 2015 and 2016. Unemployment is therefore expected to keep on its downward trend and this is likely to eventually feed through into a return to significant increases in pay rates at some point during the next three years. However, just how much those future increases in pay rates will counteract the depressive effect of increases in Bank Rate on consumer confidence, the rate of growth in consumer expenditure and the buoyancy of the housing market, are areas that will need to be kept under regular review.
Also encouraging has been the sharp fall in inflation (CPI), reaching 1.5% in May and July, the lowest rate since 2009. Forward indications are that inflation is likely to fall further in 2014 to possibly near to 1%. Overall, markets are expecting that the MPC will be cautious in raising Bank Rate as it will want to protect heavily indebted consumers from too early an increase in Bank Rate at a time when inflationary pressures are also weak. A first increase in Bank Rate is therefore expected in Q1 or Q2 2015 and they expect increases after that to be at a slow pace to lower levels than prevailed before 2008 as increases in Bank Rate will have a much bigger effect on heavily indebted consumers than they did before 2008.

The return to strong growth has also helped lower forecasts for the increase in Government debt by £73bn over the next five years, as announced in the 2013 Autumn Statement, and by an additional £24bn, as announced in the March 2014 Budget - which also forecast a return to a significant budget surplus, (of £5bn), in 2018-19. However, monthly public sector deficit figures have disappointed so far in 2014/15.

3.1.3 Eurozone

The Eurozone is facing an increasing threat from weak or negative growth and from deflation. In September, the inflation rate fell further, to reach a low of 0.3%. However, this is an average for all EZ countries and includes some countries with negative rates of inflation. Accordingly, the ECB took some rather limited action in June to loosen monetary policy in order to promote growth. In September it took further action to cut its benchmark rate to only 0.05%, its deposit rate to -0.2% and to start a programme of purchases of corporate debt. However, it has not embarked yet on full quantitative easing (purchase of sovereign debt).

Concern in financial markets for the Eurozone subsided considerably during 2013. However, sovereign debt difficulties have not gone away and major issues could return in respect of any countries that do not dynamically address fundamental issues of low growth, international uncompetitiveness and the need for overdue reforms of the economy, (as Ireland has done). It is, therefore, possible over the next few years that levels of government debt to GDP ratios could continue to rise for some countries. This could mean that sovereign debt concerns have not disappeared but, rather, have only been postponed.

3.2 Capita Asset Services interest rate forecast

Treasury advisor, Capita Asset Services, has provided the following forecast:

	Sep-14	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17
Bank rate	0.50%	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%	1.25%	1.50%	1.75%	2.00%	2.00%
5yr PWLB rate	2.70%	2.70%	2.80%	2.90%	3.00%	3.00%	3.10%	3.20%	3.30%	3.40%	3.50%	3.50%
10yr PWLB rate	3.40%	3.50%	3.60%	3.70%	3.80%	3.90%	4.00%	4.10%	4.10%	4.20%	4.30%	4.30%
25yr PWLB rate	4.00%	4.10%	4.20%	4.30%	4.40%	4.50%	4.60%	4.70%	4.80%	4.80%	4.90%	4.90%
50yr PWLB rate	4.00%	4.10%	4.20%	4.30%	4.40%	4.50%	4.60%	4.70%	4.80%	4.80%	4.90%	4.90%

Capita Asset Services undertook a review of its interest rate forecasts in mid August, after the Bank of England's Inflation Report. By the beginning of September, a further rise in geopolitical concerns, principally over Ukraine but also over the Middle East, had caused a further flight into safe havens like gilts and depressed PWLB rates further. However, there is much volatility in rates as news ebbs and flows in negative or positive ways. This latest forecast includes a first increase in Bank Rate in quarter 1 of 2015.

4. Treasury Management Strategy Statement and Annual Investment Strategy update

The Treasury Management Strategy Statement (TMSS) for 2014/15 was approved by the Authority on 17th February 2014. There are no policy changes to the TMSS; the details in this report update the position in the light of the updated economic position and budgetary changes already approved.

Prudential Indicator 2014/15	**Original Prudential Indicator**	**Revised Prudential Indicator**
Authorised Limit	£49m	£49m
Operational Boundary	£45m	£45m
Capital Financing Requirement (31.3.14)	£42m	£42m

5. The Authority's Capital Position (Prudential Indicators)

This section of the report provides an update on:

- The Authority's capital expenditure plans;
- How these plans are being financed;
- The impact of the changes in the capital expenditure plans on the prudential indicators and the underlying need to borrow; and
- Compliance with the limits in place for borrowing activity.

5.1 Prudential Indicator for Capital Expenditure

The table below shows the capital programme which was approved by the Authority 17th February 2014, it has since been revised to reflect the impact of capital expenditure and financing decisions in 2013/14

Capital Expenditure 2014/15	Approved Feb 2014 £000	Revised Estimate £000	Forecast Outturn £000
Land & Buildings:			
Asbestos Removal	30	43	43
Training at Height Facilities	220	220	270
Windows & Door Replacements	185	185	185
Roof Replacements	140	144	44
Boiler Replacement Programme	330	330	330
Rewires	65	65	65
Cradley Heath/Halesowen Project	1,700	1,758	1,758
High Rise Training Facility Oldbury	0	3	3
HQ Alterations	0	72	64
Dignity at Work	500	500	480
Vehicles:			
Vehicle Replacement Programme	493	953	953
Hazmats/Environmental Units	80	80	80
Command Support Vehicle Conversion	60	60	60
ICT & Equipment:			
Thermal Image Cameras	115	123	123
Solar Panelling Phase 2	134	136	136
Other Equipment	0	80	80
Remote Aerial Unit	80	72	50
Oracle Licensing	0	25	25
Fire Control C&C Upgrade	0	15	15
Pensions System Replacement	50	50	50
MDT Upgrade/Replacements	0	318	318
Total	**4,182**	**5,232**	**5,132**

.5.2 Changes to the Financing of the Capital Programme

The table below draws together the main strategy elements of the capital expenditure plans and the expected financing arrangements of this capital expenditure. The borrowing element of the table increases the underlying indebtedness of the Authority by way of the Capital Financing Requirement (CFR), although this will be reduced in part by revenue charges for the repayment of debt (the Minimum Revenue Provision). This direct borrowing need may also be supplemented by maturing debt and other treasury requirements.

Capital Expenditure	2014/15 Original Estimate £000	Current Position £000	2014/15 Revised Estimate £000
Total spend	**4,182**	**5,232**	**5,132**
Financed by:			
Capital receipts	0	0	0
Capital grants	4,182	4,597	4,597
Revenue contribution to Capital	0	635	535
Total financing	**4,182**	**5,232**	**5,132**
Borrowing need	**0**	**0**	**0**

5.3 Changes to the Prudential Indicators for the Capital Financing Requirement, External Debt and the Operational Boundary

The table below shows the CFR, which is the underlying external need to incur borrowing for a capital purpose. It also shows the expected debt position over the period. This is termed the Operational Boundary.

Prudential Indicator – Capital Financing Requirement

The Authority is on target to achieve the original forecast Capital Expenditure Requirement.

Prudential Indicator – External Debt / the Operational Boundary

	2014/15 Original Estimate		2014/15 Revised Estimate
Prudential Indicator – Capital Financing Requirement			
Total CFR (31.3.14)	£42m		£42m
Prudential Indicator – External Debt / the Operational Boundary			
Borrowing	£45m		£45m
Total debt 31 March 2014	£42m		£42m

5.4 Limits to Borrowing Activity

The first key control over the treasury activity is a prudential indicator to ensure that over the medium term, net borrowing (borrowings less investments) will only be for a capital purpose. Net external borrowing should not, except in the short term, exceed the total of CFR in the preceding year plus the estimates of any additional CFR for 201415 and next two financial years. This allows some flexibility for limited early borrowing for future years. The Authority has approved a policy for borrowing in advance of need which will be adhered to if this proves prudent.

	2014/15 **Original Estimate**	2014/15 **Revised Estimate**
Gross borrowing (Excluding Ex WMCC)	£38m	£38m
Capital Financing Requirement (31.3.14)	£42m	£42m

The Treasurer reports that no difficulties are envisaged for the current or future years in complying with this prudential indicator.

A further prudential indicator controls the overall level of borrowing. This is the Authorised Limit which represents the limit beyond which borrowing is prohibited, and needs to be set and revised by Members. It reflects the level of borrowing which, while not desired, could be afforded in the short term, but is not sustainable in the longer term. It is the expected maximum borrowing need with some headroom for unexpected movements. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003.

Authorised limit for external debt	2014/15 **Original Indicator**	2014/15 **Revised Indicator**
Borrowing	£49m	£49m

6. Investment Portfolio 2014/15

In accordance with the Code, it is the Authority's priority to ensure security of capital and liquidity, and to obtain an appropriate level of return which is consistent with the Authority's risk appetite. As set out in Section 3, it is a very difficult investment market in terms of earning the level of interest rates commonly seen in previous decades as rates are very low and in line with the 0.5% Bank Rate. Indeed, the introduction of the Funding for Lending scheme has reduced market investment rates even further. The potential for a prolonging of the Eurozone sovereign debt crisis, and its impact on banks, prompts a low risk and short term strategy. Given this risk environment, investment returns are likely to remain low.

The Authority held £74m of investments as at 30 September 2014 (£53m at 31 March 2014) and the investment portfolio yield for the first six months of the year is 0.42% against a benchmark *(*average 7-day LIBID rate) of 0.35%.

The Treasurer confirms that the approved limits within the Annual Investment Strategy were not breached during the first six months of 2014/15.

The Authority's budgeted investment return for 2014/15 is £0.350m, and performance for the year to date is in line with the budget.

Investment Counterparty criteria

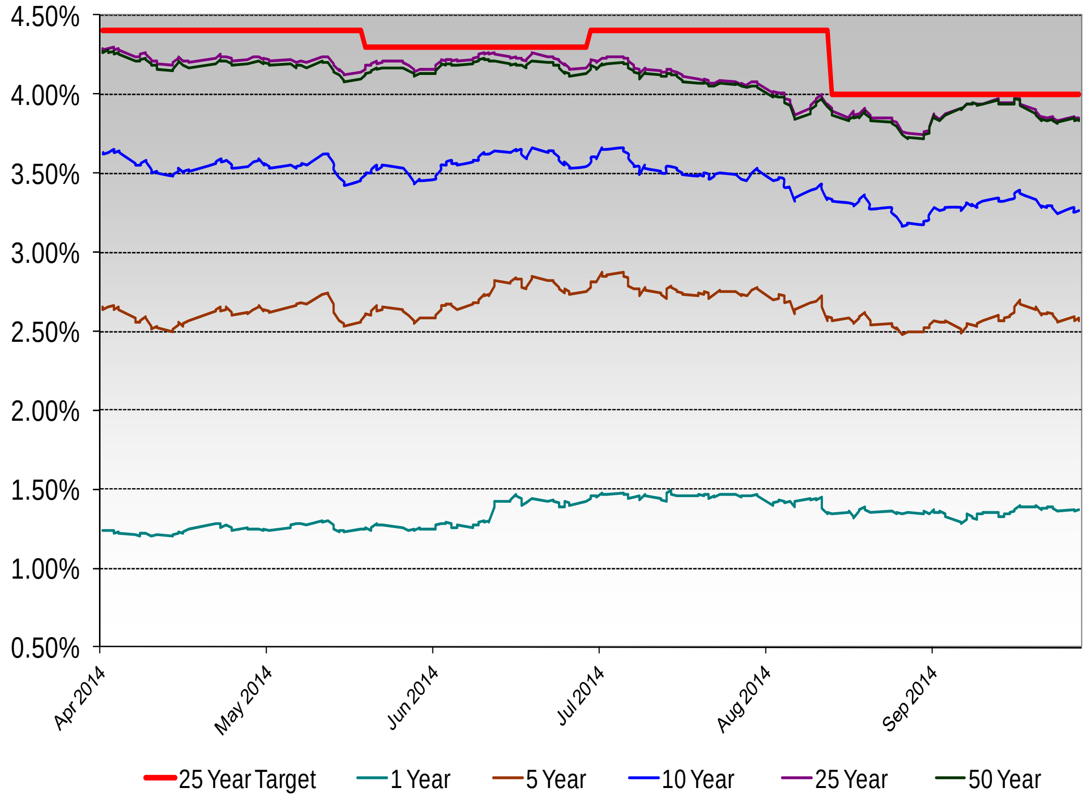
The current investment counterparty criteria selection approved in the TMSS is meeting the requirement of the treasury management function.

7. Borrowing

The Authority's capital financing requirement (CFR) for 2014/15 is £42m (31.3.14). The CFR denotes the Authority's underlying need to borrow for capital purposes. If the CFR is positive the Authority may borrow from the PWLB or the market (external borrowing) or from internal balances on a temporary basis (internal borrowing). The balance of external and internal borrowing is generally driven by market conditions.

It is not anticipated that borrowing will be undertaken during this financial year however this requirement will be monitored by the Treasurer as part of the capital financing decisions.

The graph below show the movement in PWLB rates for the first six months of the year (to 30.9.14):



8 Debt Rescheduling

No debt rescheduling was undertaken during the first six months of 2014/15. The Treasurer will continue to monitor opportunities for restructuring the Authority's debt during the remainder of the year.