WEST MIDLANDS FIRE AND RESCUE AUTHORITY

AUDIT COMMITTEE

7 SEPTEMBER 2015

1. **TREASURY MANAGEMENT – ANNUAL REPORT 2014/2015**

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 2014/2015 Treasury Management Strategy Statement & Annual Investment Strategy and its Prudential Indicators in February 2014. 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 2014/2015 and the actual Prudential Indicators for 2014/2015.

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 2014/2015.

3.2 Appendix 1, the Annual Treasury Management Report 2014/2015, 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.

7. **ENVIRONMENTAL IMPLICATIONS**

There are no environmental implications arising from this report.

BACKGROUND PAPERS

Authority's Budget and Precept Report – February 2014
Quarterly Treasury Management Reports (Sandwell MBC)
CAPITA – Treasury Management Bulletins and Newsletters

The contact officer for this report is Deputy Chief Fire Officer, Philip Hales, telephone number 0121 380 6907.

PHIL LOACH	MIKE GRIFFITHS
CHIEF FIRE OFFICER	TREASURER

Ref: AU/AC/21308154/KS/GVH

APPENDIX 1

WEST MIDLANDS FIRE SERVICE

Annual Treasury Management Review
2014/15

Ref: AU/AC/21308154/KS/GVH

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 2014/15. 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 2014/15 the minimum reporting requirements were that the Authority should receive the following reports:

- an annual treasury strategy in advance of the year (Authority 17/02/2014)
- a mid-year treasury update report (Audit Committee 13/10/2014)
- 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 2014/15 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	2013/14	2014/15
Actual capital expenditure	£5.096m	£3.036m
Total Capital Financing Requirement	£41.870m	£40.211m
Financing costs to net revenue stream	5.57%	3.63%

The Treasurer confirms that no borrowing was undertaken for any capital purpose during 2014/15 and that the statutory borrowing limit (the authorised limit), was not breached.

As at 31st March 2015, the Authority's external debt was £40.751m (£41.784m as at 31st March 2014) and its investment totalled £65.4m (£53.4m as at 31st March 2014).

2. The Economy and Interest Rates

The original market expectation at the beginning of 2014/15 was for the first increase in Bank Rate to occur in quarter 1 2015 as the unemployment rate had fallen much faster than expected through the Bank of England’s initial forward guidance target of 7%. In May, however, the Bank revised its forward guidance. A combination of very weak pay rises and inflation above the rate of pay rises meant that consumer disposable income was still being eroded and in August the Bank halved its forecast for pay inflation in 2014 from 2.5% to 1.25%. Expectations for the first increase in Bank Rate therefore started to recede as growth was still heavily dependent on buoyant consumer demand. During the second half of 2014 financial markets were caught out by a halving of the oil price and the collapse of the peg between the Swiss franc and the euro. Fears also increased considerably that the ECB was going to do too little too late to ward off the threat of deflation and recession in the Eurozone. In mid-October, financial markets had a major panic for about a week. By the end of 2014, it was clear that inflation in the UK was going to head towards zero in 2015 and possibly even turn negative. In turn, this made it clear that the MPC would have great difficulty in starting to raise Bank Rate in 2015 while inflation was around zero and so market expectations for the first increase receded back to around quarter 3 of 2016.

Gilt yields were on a falling trend for much of the last eight months of 2014/15 but were then pulled in different directions by increasing fears after the anti-austerity parties won power in Greece in January; developments since then have increased fears that Greece could be heading for an exit from the euro. While the direct effects of this would be manageable by the EU and ECB, it is very hard to quantify quite what the potential knock on effects would be on other countries in the Eurozone once the so called impossibility of a country leaving the EZ had been disproved. Another downward pressure on gilt yields was the announcement in January that the ECB would start a major programme of quantitative easing, purchasing EZ government and other debt in March. On the other hand, strong growth in the US caused an increase in confidence that the US was well on the way to making a full recovery from the financial crash and would be the first country to start increasing its central rate, probably by the end of 2015. The UK would be closely following it due to strong growth over both 2013 and 2014 and good prospects for a continuation into 2015 and beyond. However, there was also an increase in concerns around political risk from the general election due in May 2015.

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.

	2013/14 Actual £m	2014/15 Actual £m
Total capital expenditure	**5.096**	**3.036**
Resourced by:		
• Capital receipts	0	0
• Capital grants	5.096	3.036
• Revenue Contribution to Capital	0	0
Capital Expenditure Financed from Borrowing	**0**	**0**

4. Overall Treasury Position as at 31 March 2015

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 2014/15 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 2014/15 was approved 17th February 2014.

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

CFR	31 March 2014 Actual £m	31 March 2015 Actual £m
Opening balance	45.662	41.870
Add unfinanced capital expenditure	0	0
Less MRP	(1,792)	(1,659)
Less VRP	(2,000)	0
Closing balance	41,870	40,211

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 (2014/15) plus the estimates of any additional capital financing requirement for the current (2015/16) 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 2014/15.

	31 March 2014 Actual £m	31 March 2015 Actual £m
External Debt	41.784	40.751
Investments	53.383	65.425
Net Borrowing Position	(11.599)	(24.674)
CFR	41.870	40.211

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 2014/15 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.

	2013/14	2014/15
Authorised limit	£51m	£49m
Operational boundary	£47m	£45m
Maximum gross borrowing position	£43m	£42m
Financing costs as a proportion of net revenue stream	5.57%	3.63%

5. Overall Treasury Position as at 31 March 2015

The Authority's debt and 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 2014/15 the Authority's position was as follows:

	31 March 2014 Principal	Rate/ Return	31 March 2015 Principal	Rate/ Return
Fixed Rate Loans:				
PWLB	*£37.8*	*5.8%*	*£36.9*	*5.7%*
Ex WMCC	*£4.0*	*6.5%*	*£3.8*	*6.6%*
Total Debt	*£41.8*	*5.9%*	*£40.7*	*5.8%*
CFR	***£41.9***		***£40.2***	
Over / (under) borrowing	***(£0.1)***		***£0.5***	
Investments:				
Sandwell MBC	*£53.4*	*0.4%*	*£65.4*	*0.4%*
Net Debt	**(£11.6)**		**(£24.7)**	

The maturity structure of the debt portfolio was as follows:

	31 March 2014 Actual £m	31 March 2015 Actual £m
Under 12 months	1.033	1.052
12 months and within 24 months	1.052	2.337
24 months and within 5 years	3.698	1.665
5 years and within 10 years	6.162	6.348
10 years and above	29.839	29.349

6. The Strategy for 2014/15

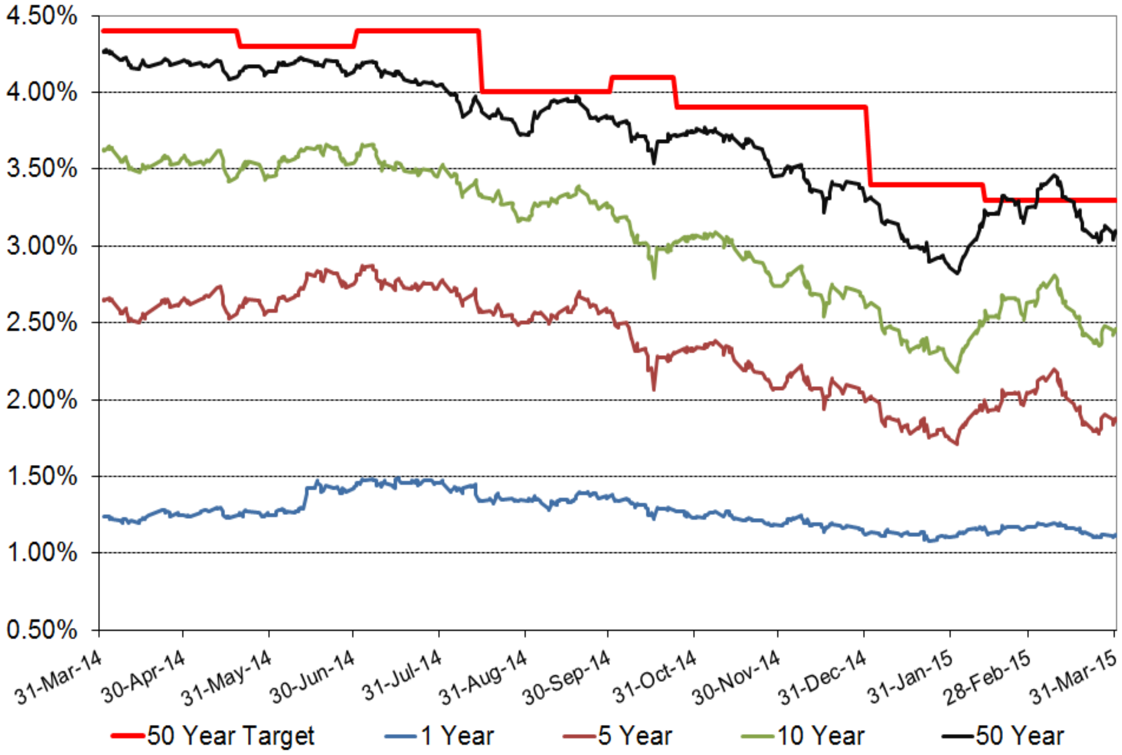
The expectation for interest rates within the strategy for 2014/15 anticipated low but rising Bank Rate (starting in quarter 1 of 2015), and gradual rises in medium and longer term fixed borrowing rates during 2014/15. Variable, or short-term rates, were expected to be the cheaper form of borrowing over 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 that PWLB rates saw little overall change during the first four months of the year but there was then a downward trend for the rest of the year with a partial reversal during February.

7. Borrowing Rates in 2014/15

PWLB borrowing rates - the graph below shows how PWLB certainty rates have risen from historically very low levels during the year.



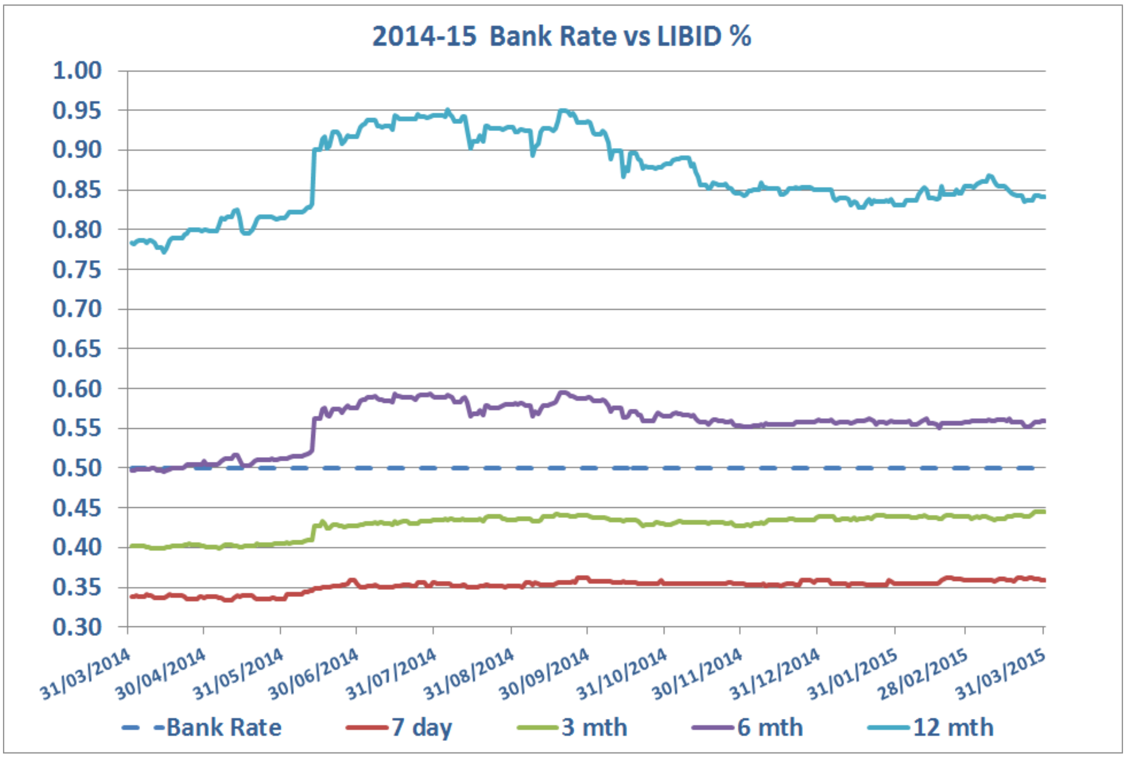
8. Borrowing Outturn for 2014/15

Borrowing – No borrowing was undertaken during 2014/15.

Rescheduling – No rescheduling was undertaken during 2014/15.

9. Investment Rates in 2014/15

Bank Rate remained at its historic low of 0.5% throughout the year; it has now remained unchanged for six years. Market expectations as to the timing of the start of monetary tightening started the year at quarter 1 2015 but then moved back to around quarter 3 2016 by the end of the year. Deposit rates remained depressed during the whole of the year, primarily due to the effects of the Funding for Lending Scheme.



10. Investment Outturn for 2014/15

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 17th February 2014. 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 £65.4m of internally managed funds. The internally managed funds earned an average rate of return of 0.38%. The comparable performance indicator is the average 7-day LIBID rate, which was 0.35%. This compares with a budget assumption of £60m investment balances earning an average rate of 0.5%.