

**WEST MIDLANDS FIRE AND RESCUE AUTHORITY**

**AUDIT COMMITTEE**

**15 OCTOBER 2012**

**1. TREASURY MANAGEMENT – MID YEAR REVIEW 2012/13**

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 Treasury Management Strategy Statement & Annual Investment Strategy and its Prudential Indicators in February 2012. Part of the requirements of the Treasury Strategy and Prudential Code are that periodic reports are presented to Members.
- 2.2 The mid-year review report outlines the performance of the Treasury Management function of the Authority in the current financial year.

**3. BACKGROUND**

- 3.1 The Authority is required to produce a mid-year report of Treasury Management activity in the current financial year.
- 3.2 Appendix 1, the Mid-year Review Report 2012/13, 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 2012  
Quarterly Treasury Management Reports (Sandwell MBC)

V. RANDENIYA  
CHIEF FIRE OFFICER

S. KELLAS  
TREASURER

**WEST MIDLANDS FIRE SERVICE**

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**Treasury Management Strategy  
Statement and Annual Investment  
Strategy**

Mid-year Review Report 2012/13

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## 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 2012/13;
- 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 2012/13;
- A review of the Authority's borrowing strategy for 2012/13;
- A review of any debt rescheduling undertaken during 2012/13;
- A review of compliance with Treasury and Prudential Limits for 2012/13.

### 3 Economic update

#### 3.1 Economic performance to date

Economic sentiment, in respect of the prospects for the UK economy to recover swiftly from recession, suffered a major blow in August when the Bank of England substantially lowered its expectations for the speed of recovery and rate of growth over the coming months and materially amended its forecasts for 2012 and 2013. It was noted that the UK economy is heavily influenced by worldwide economic developments, particularly in the Eurozone, and that on-going negative sentiment in that area would inevitably permeate into the UK's economic performance.

With regard to the Eurozone, investor confidence remains weak because successive "rescue packages" have first raised, and then disappointed, market expectations. However, the uncertainty created by the continuing Eurozone debt crisis is having a major effect in undermining business and consumer confidence not only in Europe and the UK, but also in America and the Far East/China.

In the UK, consumer confidence remains very depressed with unemployment concerns, indebtedness and a squeeze on real incomes from high inflation and low pay rises, all taking a toll. Whilst inflation has fallen considerably (CPI @ 2.6% in July), UK GDP fell by 0.5% in the quarter to 30 June, the third quarterly fall in succession. This means that the UK's recovery from the initial 2008 recession has been the worst and slowest of any G7 country apart from

Italy (G7 = US, Japan, Germany, France, Canada, Italy and UK). It is also the slowest recovery from a recession of any of the five UK recessions since 1930 and total GDP is still 4.5% below its peak in 2008.

This weak recovery has caused social security payments to remain elevated and tax receipts to be depressed. Consequently, the Chancellor's plan to eliminate the annual public sector borrowing deficit has been pushed back further into the future. The Monetary Policy Committee has kept Bank Rate at 0.5% throughout the period while quantitative easing was increased by £50bn to £375bn in July. In addition, in June, the Bank of England and the Government announced schemes to free up banking funds for business and consumers.

On a positive note, despite all the bad news on the economic front, the UK's sovereign debt remains one of the first ports of call for surplus cash to be invested in and gilt yields, prior to the ECB bond buying announcement in early September, were close to zero for periods out to five years and not that much higher out to ten years.

### 3.2 Outlook for the next six months of 2012/13

The risks in economic forecasts continue unabated from the previous treasury strategy. Concern has been escalating that the Chinese economy is heading for a hard landing, rather than a gentle slowdown, while America is hamstrung by political deadlock which prevents a positive approach to countering weak growth. Whether the presidential election in November will remedy this deadlock is debatable but urgent action will be required early in 2013 to address the US debt position. However, on 13<sup>th</sup> September the Fed. announced an aggressive stimulus programme for the economy with a third round of quantitative easing focused on boosting the stubbornly weak growth in job creation, and this time with no time limit. They also announced that it was unlikely that there would be any increase in interest rates until at least mid 2015.

Eurozone growth will remain weak as austerity programmes in various countries curtail economic recovery. A crunch situation is rapidly developing in Greece as it has failed yet again to achieve deficit reduction targets and so may require yet another (third) bail out. There is the distinct possibility that some of the northern European countries could push for the ejection of Greece from the Eurozone unless its financial prospects improve, which does not seem likely at this juncture. A financial crisis was also rapidly escalating over the situation in Spain. However, in early September the ECB announced that it would purchase unlimited amounts of shorter term bonds of Eurozone countries which have formally agreed the terms for a bailout. Importantly, this support would be subject to conditions (which have yet to be set) and include

supervision from the International Monetary Fund. This resulted in a surge in confidence that the Eurozone has at last put in place the framework for adequate defences to protect the Euro. However, it remains to be seen whether the politicians in charge of Spain and Italy will accept such loss of sovereignty in the light of the verdicts that voters have delivered to the politicians in other peripheral countries which have accepted such supervision and austerity programmes. The Eurozone crisis is therefore far from being resolved as yet. The immediate aftermath of this announcement was a rise in bond yields in safe haven countries, including the UK. Nevertheless, this could prove to be as short lived as previous “solutions” to the Eurozone crisis.

The Bank of England Quarterly Inflation Report in August pushed back the timing of the return to trend growth and also lowered its inflation expectations. Nevertheless, concern remains that the Bank’s forecasts of a weaker and delayed robust recovery may still prove to be over optimistic given the world headwinds the UK economy faces. Weak export markets will remain a drag on the economy and consumer expenditure will continue to be depressed due to a focus on paying down debt, negative economic sentiment and job fears. The Coalition Government, meanwhile, is likely to be hampered in promoting growth by the requirement of maintaining austerity measures to tackle the budget deficit.

The overall balance of risks is, therefore, weighted to the downside:

- Sector, who is the Treasury Management advisors to Sandwell MBC expect low growth in the UK to continue, with Bank Rate unlikely to rise in the next 24 months, coupled with a possible further extension of quantitative easing. This will keep investment returns depressed.
- The expected longer run trend for PWLB borrowing rates is for them to eventually rise, primarily due to the need for a high volume of gilt issuance in the UK and the high volume of debt issuance in other major western countries. However, the current safe haven status of the UK may continue for some time, tempering any increases in yield.
- This interest rate forecast is based on an assumption that growth starts to recover in the next three years to a near trend rate (2.5%). However, if the Eurozone debt crisis worsens as a result of one or more countries having to leave the Euro, or low growth in the UK continues longer, then Bank Rate is likely to be depressed for even longer than in this forecast.

### 3.3 Sector's interest rate forecast

	17.9.12 actual	Dec-12	Mar-13	Jun-13	Sep-13	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15
<b>BANK RATE</b>	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.75	1.00
<b>3m LIBID</b>	0.55	0.60	0.60	0.60	0.60	0.60	0.60	0.70	0.90	1.10	1.40
<b>6m LIBID</b>	0.85	0.85	0.85	0.85	0.85	0.85	1.00	1.10	1.30	1.50	1.80
<b>12m LIBID</b>	1.30	1.30	1.30	1.30	1.40	1.50	1.70	1.90	2.10	2.30	2.60
<b>5yr PWLB</b>	1.89	1.50	1.50	1.50	1.60	1.70	1.80	1.90	2.00	2.10	2.30
<b>10yr PWLB</b>	2.91	2.50	2.50	2.50	2.60	2.70	2.80	2.90	3.00	3.20	3.30
<b>25yr PWLB</b>	4.15	3.70	3.70	3.70	3.80	3.80	3.90	4.00	4.10	4.20	4.30
<b>50yr PWLB</b>	4.32	3.90	3.90	3.90	4.00	4.00	4.10	4.20	4.30	4.40	4.50

The above Sector forecasts for PWLB rates incorporate the introduction of the PWLB certainty rate in November 2012 which will reduce PWLB borrowing rates by 0.20% for most local authorities. The actual PWLB rates on 17<sup>th</sup> September 2012 ought therefore to be reduced by 20bps to provide a true comparison to the forecasts.

## 4 Treasury Management Strategy Statement and Annual Investment Strategy update

The Treasury Management Strategy Statement (TMSS) for 2012/13 was approved by the Authority on 13<sup>th</sup> February 2012. 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.

<b>Prudential Indicator 2012/13</b>	<b>Original Prudential Indicator</b>	<b>Revised Prudential Indicator</b>
Authorised Limit	£61m	£61m
Operational Boundary	£56m	£56m
Capital Financing Requirement (31.3.13)	£51m	£51m

## 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 13<sup>th</sup> February 2012, it has since been revised to reflect the impact of capital expenditure and financing decisions in 2011/12

<b>Capital Expenditure</b>	<b>2012/13 Approved February 2012 £000</b>	<b>2012/13 Revised Estimate £000</b>	<b>2012/13 Forecast Outturn £000</b>
<b>Land &amp; Buildings:</b>			
Asbestos Removal	0	68	68
Drill Tower / Training Facilities Upgrade	220	245	245
The Academy Refurbishment	0	8	8
Solihull Refurbishment	12	275	239
Walsall Refurbishment	10	512	465
Boiler Replacement Programme	477	516	200
Lighting / Electrical Upgrades	0	26	36
Halesowen / Cradley Heath Project	0	0	19
Handsworth Red Hot Educational Facility	0	70	32
Retention / Completed Schemes	0	9	8
<b>Vehicles:</b>			
Vehicle Replacement Programme*	2,490	6,226	6,226
<b>ICT &amp; Equipment:</b>			
Solar Panels	0	482	482
Thermal Image Cameras	18	186	186
Other Equipment	0	13	13
Oracle Licensing	0	25	25
<b>Total</b>	<b>3,390</b>	<b>8,661</b>	<b>8,252</b>

\* The Vehicle Replacement Programme forecast outturn is subject to the outcome of a review to determine the future make up of Operational fleet.

## 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.

<b>Capital Expenditure</b>	<b>2012/13 Original Estimate £000</b>	<b>Current Position £000</b>	<b>2012/13 Revised Estimate £000</b>
<b>Total spend</b>	<b>3,390</b>	<b>8,661</b>	<b>8,252</b>
<i>Financed by:</i>			
Capital receipts	0	267	267
Capital grants	2,915	4,111	4,111
Revenue contribution to Capital	475	4,283	3,874
<b>Total financing</b>	<b>3,390</b>	<b>8,661</b>	<b>8,252</b>
<b>Borrowing need</b>	<b>0</b>	<b>0</b>	<b>0</b>

## 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 Financing Requirement

## Prudential Indicator – External Debt / the Operational Boundary

	2012/13 Original Estimate	2012/13 Revised Estimate
Prudential Indicator – Capital Financing Requirement		
Total CFR (31.3.13)	£51m	£51m
Prudential Indicator – External Debt / the Operational Boundary		
Borrowing	£56m	£56m
Total debt 31 March 2012	£45m	£45m

### 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 2012/13 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.

	2012/13 <b>Original Estimate</b>	2012/13 <b>Revised Estimate</b>
Gross borrowing (Excluding Ex WMCC)	£40m	£40m
Less investments	£25m	£30m
Net borrowing	£15m	£10m
Capital Financing Requirement (31.3.13)	£51m	£51m

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.

<b>Authorised limit for external debt</b>	<b>2012/13 Original Indicator</b>	<b>2012/13 Revised Indicator</b>
Borrowing	£61m	£61m

## 6 Investment Portfolio 2012/13

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. The continuing Euro zone sovereign debt crisis, and its potential impact on banks, prompts a low risk and short term strategy. Given this risk adverse environment, investment returns are likely to remain low.

The Authority held £53m of investments as at 30 September 2012 (£33m at 31 March 2012) and the investment portfolio yield for the first six months of the year is 0.65% against a benchmark (average 7-day LIBID rate) of 0.43%.

The Treasurer confirms that the approved limits within the Annual Investment Strategy were not breached during the first six months of 2012/13.

The Authority's budgeted investment return for 2012/13 is £0.2m, and performance for the year to date is in line with the budget.

### Investment Counterparty criteria

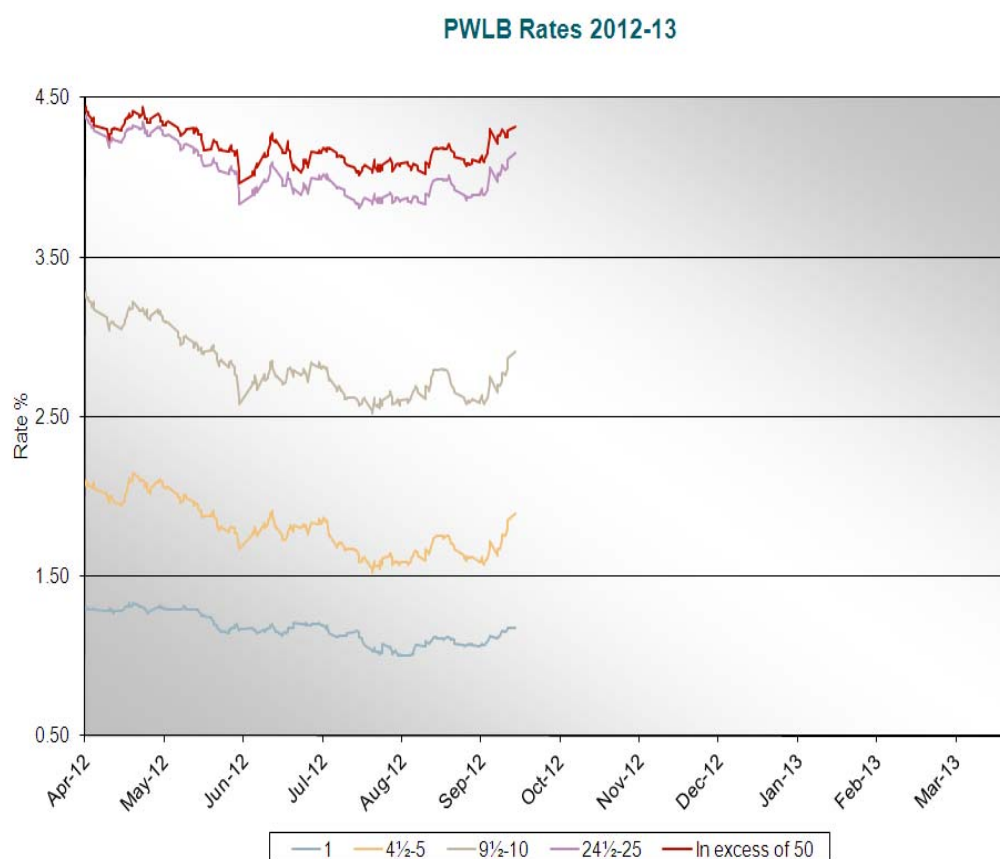
The current investment counterparty criteria selection approved in the TMSS is meeting the requirement of the treasury management function.

## 7 Borrowing

The Authority's capital financing requirement (CFR) for 2012/13 is £51m. 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 and table below show the movement in PWLB rates for the first six months of the year (to 10.9.12):



## 8 Debt Rescheduling

No debt rescheduling was undertaken during the first six months of 2012/13