WEST MIDLANDS FIRE AND RESCUE AUTHORITY

AUDIT COMMITTEE

14 OCTOBER 2013

1. TREASURY MANAGEMENT ANNUAL REPORT 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 2012/13 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 annual treasury report covers the treasury activity during 2012/13 and the actual Prudential Indicators for 2012/13.

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 2012/13.

3.2 Appendix 1, the Annual Treasury Management 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)
SECTOR – Treasury Management Bulletins and Newsletters

The contact name for this report is Mike Griffiths, Director of Resources, 0121 380 6907.

V. RANDENIYA
CHIEF FIRE OFFICER

S. KELLAS
TREASURER

APPENDIX 1

WEST MIDLANDS FIRE SERVICE

Annual Treasury Management Review 2012/13

IL0 - Unclassified

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 2012/13. 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 2012/13 the minimum reporting requirements were that Members should receive the following reports:

- an annual treasury strategy in advance of the year (Authority 13/02/2012)
- a mid-year (minimum) treasury update report (Audit Committee 15/10/2012)
- 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 2012/13 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	2011/12	2012/13
Actual capital expenditure	£3.658m	£1.938m
Capital Financing Requirement	£52.428m	£45.662m
Financing costs to net revenue stream	4.3%	4.0%

The Treasurer confirms that no borrowing was undertaken for any capital purpose during 2012/13 and that the statutory borrowing limit (the authorised limit), was not breached.

As at 31st March 2013, the Authority's external debt was £43.221m (£44.644m as at 31st March 2012) and its investment totalled £40.5m (£33.2m as at 31st March 2012).

2. The Economy and Interest Rates

The financial year 2012/13 continued the challenging investment environment of previous years, namely low investment returns and continuing heightened levels of counterparty risk. The original expectation for 2012/13 was that Bank Rate would start gently rising from quarter 4 2014. However, economic growth in the UK was disappointing during the year due to the UK austerity programme, weak consumer confidence and spending, a lack of rebalancing of the UK economy to exporting and weak growth in our biggest export market - the European Union (EU). The UK coalition Government maintained its tight fiscal policy stance against a background of warnings from two credit rating agencies that the UK could lose its AAA credit rating. Moody's followed up this warning by actually downgrading the rating to AA+ in February 2013 and Fitch then placed their rating on negative watch, after the Budget statement in March. Key to retaining the AAA rating from Fitch and S&P will be a return to strong economic growth in order to reduce the national debt burden to a sustainable level, within a reasonable timeframe. Weak UK growth resulted in the Monetary Policy Committee increasing quantitative easing by £50bn in July to a total of £375bn. Bank Rate therefore ended the year unchanged at 0.5% while CPI inflation fell from 3% at the start of the year to end at 2.8% in March, with a fall back to below 2% pushed back to quarter 1 2016. The EU sovereign debt crisis was an ongoing saga during the year with first Greece and then Cyprus experiencing crises which were met with bailouts after difficult and fraught negotiations.

Gilt yields oscillated during the year as events in the ongoing Eurozone debt crisis ebbed and flowed, causing corresponding fluctuations in safe haven flows into / out of UK gilts. This, together with a further £50bn of QE in July and widely expected further QE still to come, combined to keep PWLB rates depressed for much of the year at historically very low levels.

Deposit rates. The Funding for Lending Scheme, announced in July, resulted in a flood of cheap credit being made available to banks and this has resulted in money market investment rates falling sharply in the second half of the year. However, perceptions of counterparty risk have improved after the ECB statement in July that it would do "whatever it takes" to support struggling Eurozone countries. This has resulted in some return of confidence to move away from only very short term investing.

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.

	2011/12 Actual £m	2012/13 Actual £m
Total capital expenditure	**3.658**	**1.938**
Resourced by:		
• **Capital receipts**	**0**	**0**
• **Capital grants**	**2.996**	**1.938**
• **Revenue Contribution to Capital**	**662**	**0**
Capital Expenditure Financed from Borrowing	**0**	**0**

4. Overall Treasury Position as at 31 March 2013

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 2012/13 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 2012/13 was approved 13th February 2012.

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

CFR	31 March 2012 Actual £m	31 March 2013 Actual £m
Opening balance	**54.540**	**52.428**
Add unfinanced capital expenditure	**0**	**0**
Less MRP	**(2.112)**	**(2.047)**
Less VRP*	**0**	**(4.719)**
Closing balance	**52.428**	**45.662**

**** Includes voluntary application of capital receipts £1.719m***

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

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 2012/13 plus the expected changes to the CFR over 2013/14 and 2014/15 from financing the capital programme. This indicator allows the Authority some flexibility to borrow in advance of its immediate capital needs in 2012/13. The table below highlights the Authority's net borrowing position against the CFR. The Authority has complied with this prudential indicator.

It should be noted that this indicator is changing to compare gross borrowing to the CFR with effect from 2013/14; this is expected to provide a more appropriate indicator.

	31 March 2012 Actual £m	31 March 2013 Actual £m
External Debt	**44.644**	**43.222**
Investments	**33.194**	**40.509**
Net Borrowing Position	**11.450**	**2.712**
CFR	**52.428**	**45.662**

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 2012/13 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.

	2011/12	2012/13
Authorised limit	**£63m**	**£61m**
Operational boundary	**£58m**	**£56m**
Maximum gross borrowing position	**£45m**	**£45m**
Financing costs as a proportion of net revenue stream	**4.3%**	**4.0%**

5. Treasury Position as at 31st March 2013

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 2012/13 the Authority's treasury position was as follows:

	31 March 2012 Principal	Rate/ Return	31 March 2013 Principal	Rate/ Return
Fixed Rate Loans:				
PWLB	***£40.3m***	***6.0%***	***£39.0m***	***5.9%***
Ex WMCC	***£4.4m***	***6.6%***	***£4.2m***	***6.6%***
Total Debt	***£44.7m***	***6.1%***	***£43.2m***	***6.0%***
CFR	***£52.4m***		***£45.7m***	
Over / (under) borrowing	***(£7.7m)***		***(£2.5m)***	
Investments:				
Sandwell MBC	***£33.2m***	***0.9%***	***£40.5m***	***0.6%***
Net Debt	**£11.5m**		**£2.7m**	

The maturity structure of the debt portfolio was as follows:

	31 March 2012 Actual £m	31 March 2013 Actual £m
Under 12 months	1.422	1.437
12 months and within 24 months	1.437	1.033
24 months and within 5 years	3.157	3.388
5 years and within 10 years	7.093	6.656
10 years and above	31.535	30.707

6. The Strategy for 2012/13

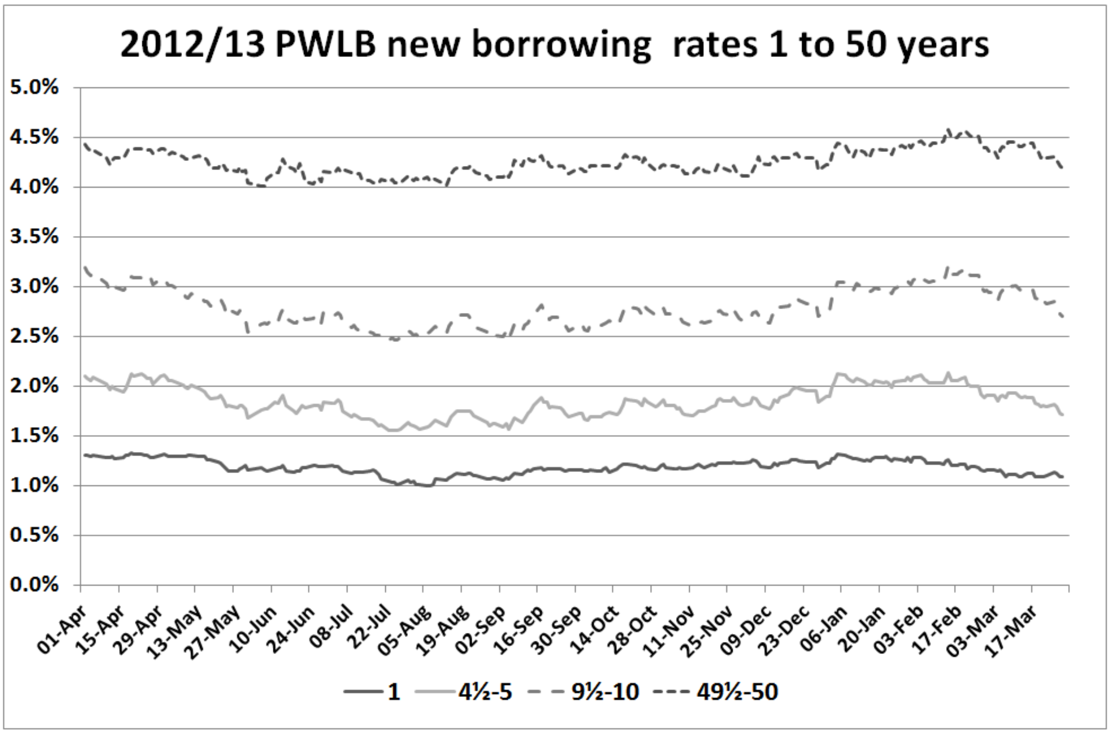
The expectation for interest rates within the strategy for 2012/13 anticipated a low but rising Bank Rate (starting in quarter 4 of 2014) with similar gradual rises in medium and longer term fixed borrowing rates over 2012/13. Variable or short-term rates were expected to be the cheaper form of borrowing 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 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 fell during the first quarter of the year to historically low levels. This was caused by a flight to quality into UK gilts from EU sovereign debt, and from shares, as investors became concerned about the potential for a Lehman's type crisis of financial markets if the Greek debt crisis were to develop into a precipitous default and exit from the Euro. During the second and third quarters, rates rose gradually and agreement of a second bail out for Greece in December saw the flight to quality into gilts reverse somewhat, as confidence rose that the Eurozone crisis was finally subsiding. However, gilt yields then fell back again during February and March as Eurozone concerns returned, with the focus now shifting to Cyprus, and flight to quality flows into gilts resumed. This was a volatile year for PWLB rates, driven by events in the Eurozone which oscillated between crises and remedies.

7. Borrowing Rates in 2012/13

PWLB borrowing rates - the graph below shows how PWLB rates remained close to historically very low levels during the year.



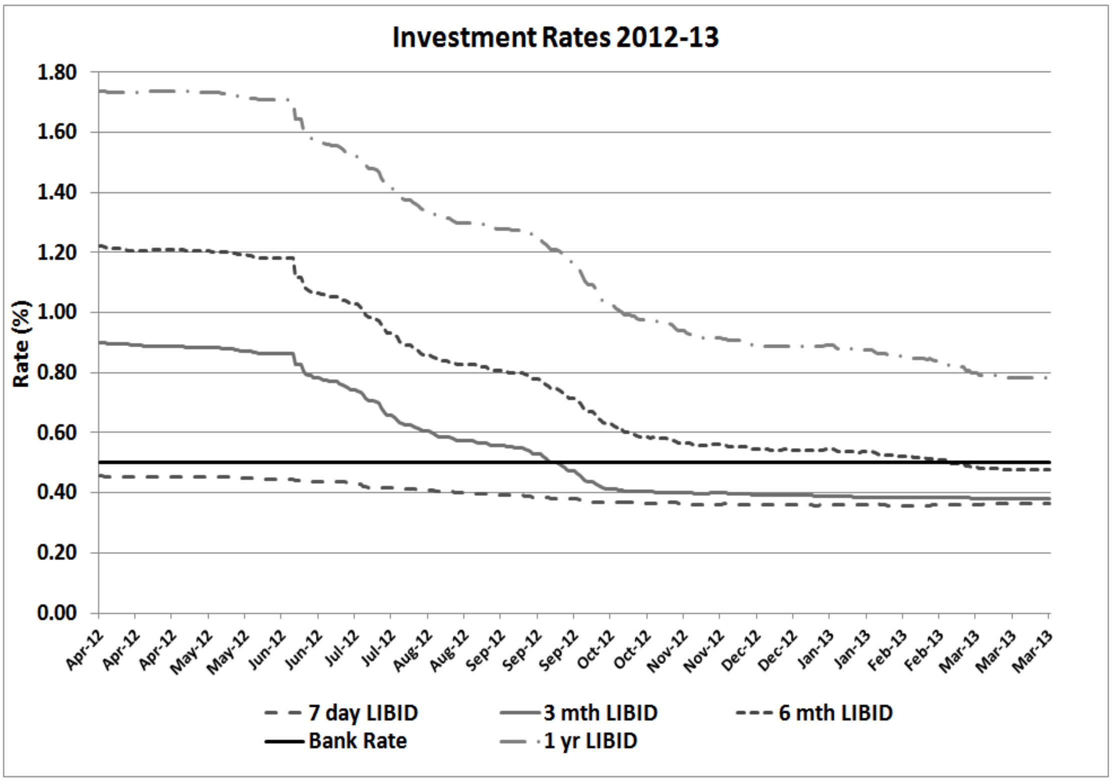
8. Borrowing Outturn for 2012/13

Borrowing – No borrowing was undertaken during 2012/13.

Rescheduling – No rescheduling was undertaken during 2012/13.

9. Investment Rates in 2012/13

Bank Rate remained at its historic low of 0.5% throughout the year; it has now remained unchanged for four years. Market expectations of the start of monetary tightening were pushed back during the year to early 2015 at the earliest. The Funding for Lending Scheme resulted in a sharp fall in deposit rates in the second half of the year.



10. Investment Outturn for 2012/13

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 13th February 2012. 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 £44.3m of internally managed funds. The internally managed funds earned an average rate of return of 0.61%. The comparable performance indicator is the average 7-day LIBID rate, which was 0.39%. This compares with a budget assumption of £37.5m investment balances earning an average rate of 0.67%.