APPENDIX 1

WEST MIDLANDS FIRE SERVICE

Treasury Management Strategy Statement and Annual Investment Strategy

Mid-year Review Report 2017/18

Ref: AU/AC/KS/

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:

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

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

- Receipt by the 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.

- 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.

- 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 2017/18;

- 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 2017/18;

- A review of the Authority's borrowing strategy for 2017/18;

- A review of any debt rescheduling undertaken during 2017/18;

- A review of compliance with Treasury and Prudential Limits for 2017/18.

3. Economic update

Economic performance to date and outlook

UK. After the UK economy surprised on the upside with strong growth in 2016, growth in 2017 has been disappointingly weak; quarter 1 came in at only +0.3% (+1.7% y/y) and quarter 2 was +0.3% (+1.5% y/y) which meant that growth in the first half of 2017 was the slowest for the first half of any year since 2012. The main reason for this has been the sharp increase in inflation, caused by the devaluation of sterling after the referendum, feeding increases in the cost of imports into the economy. This has caused, in turn, a reduction in consumer disposable income and spending power and so the services sector of the economy, accounting for around 75% of GDP, has seen weak growth as consumers cut back on their expenditure. However, more recently there have been encouraging statistics from the manufacturing sector which is seeing strong growth, particularly as a result of increased demand for exports. It has helped that growth in the EU, our main trading partner, has improved significantly over the last year. However, this sector only accounts for around 11% of GDP so expansion in this sector will have a much more muted effect on the average total GDP growth figure for the UK economy as a whole.

The Monetary Policy Committee (MPC) meeting of 14 September 2017 surprised markets and forecasters by suddenly switching to a much more aggressive tone in terms of its words around warning that Bank Rate will need to rise. The Bank of England Inflation Reports during 2017 have clearly flagged up that they expected CPI inflation to peak at just under 3% in 2017, before falling back to near to its target rate of 2% in two years time. Inflation actually came in at 2.9% in August, (this data was released on 12 September), and so the Bank revised its forecast for the peak to over 3% at the 14 September meeting MPC. This marginal revision can hardly justify why the MPC became so aggressive with its wording; rather, the focus was on an emerging view that with unemployment falling to only 4.3%, the lowest level since 1975, and improvements in productivity being so weak, that the amount of spare capacity in the economy was significantly diminishing towards a point at which they now needed to take action. In addition, the MPC took a more tolerant view of low wage inflation as this now looks like a common factor in nearly all western economies as a result of increasing globalisation. This effectively means that the UK labour faces competition from overseas labour e.g. in outsourcing work to third world countries, and this therefore depresses the negotiating power of UK labour. However, the Bank was also concerned that the withdrawal of the UK from the EU would effectively lead to a decrease in such globalisation pressures in the UK, and so would be inflationary over the next few years.

It therefore looks very likely that the MPC will increase Bank Rate to 0.5% in November or, if not, in February 2018. The big question after that will be whether this will be a one off increase or the start of a slow, but regular, increase in Bank Rate. As at the start of October, short sterling rates are indicating that financial markets do not expect a second increase until May 2018 with a third increase in November 2019. However, some forecasters are flagging up that they expect growth to improve significantly in 2017 and into 2018, as the fall in inflation will bring to an end the negative impact on consumer spending power while a strong export performance will compensate for weak services sector growth. If this scenario were to materialise, then the MPC would have added reason to embark on a series of slow but gradual increases in Bank Rate during 2018. While there is so much uncertainty around the Brexit negotiations, consumer confidence, and business confidence to spend on investing, it is far too early to be confident about how the next two years will pan out.

EU. Economic growth in the EU, (the UK's biggest trading partner), has been lack lustre for several years after the financial crisis despite the ECB eventually cutting its main rate to -0.4% and embarking on a massive programme of QE. However, growth picked up in 2016 and now looks to have gathered ongoing substantial strength and momentum thanks to this stimulus. GDP growth was 0.5% in quarter 1 (2.0% y/y) and 0.6% in quarter (2.3% y/y). However, despite providing massive monetary stimulus, the European Central Bank is still struggling to get inflation up to its 2% target and in August inflation was 1.5%. It is therefore unlikely to start on an upswing in rates until possibly 2019.

USA. Growth in the American economy has been volatile in 2015 and 2016. 2017 is following that path again with quarter 1 coming in at only 1.2% but quarter 2 rebounding to 3.1%, resulting in an overall annualised figure of 2.1% for the first half year. Unemployment in the US has also fallen to the lowest level for many years, reaching 4.4%, while wage inflation pressures, and inflationary pressures in general, have been building. The Fed has started on a gradual upswing in rates with three increases since December 2016; and there could be one more rate rise in 2017 which would then lift the central rate to 1.25 – 1.50%. There could then be another four more increases in 2018. At its June meeting, the Fed strongly hinted that it would soon begin to unwind its $4.5 trillion balance sheet holdings of bonds and mortgage backed securities by reducing its reinvestment of maturing holdings.

Capita Asset Services interest rate forecast

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

	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20
Bank rate	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
5yr PWLB rate	1.50%	1.60%	1.70%	1.70%	1.80%	1.80%	1.90%	1.90%	2.00%	2.00%
10yr PWLB rate	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
25yr PWLB rate	2.90%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.30%
50yr PWLB rate	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]

Capita Asset Services undertook its last review of interest rate forecasts in August 2017 after the quarterly Bank of England Inflation Report. There was no change in MPC policy at that meeting. However, the MPC meeting of 14 September revealed a sharp change in sentiment whereby a majority of MPC members said they would be voting for an increase in Bank Rate "over the coming months". It is therefore possible that there will be an increase to 0.5% at the November MPC meeting. If that happens, the question will then be as to whether the MPC will stop at just withdrawing the emergency Bank Rate cut of 0.25% in August 2016, after the result of the EU withdrawal referendum, or whether they will embark on a series of further increases in Bank Rate during 2018.

Since Capita Asset Services undertook its last review of interest rate forecasts, the MPC announced on 2 November 2017 an increase to the Bank Rate of 0.25% to 0.50%, the first increase since July 2007.

The overall balance of risks to economic recovery in the UK is currently to the downside but huge variables over the coming few years include just what final form Brexit will take, when finally agreed with the EU, and when.

4. **Treasury Management Strategy Statement and Annual Investment Strategy update**

The Treasury Management Strategy Statement (TMSS) for 2017/18 was approved by the Authority on 20th February 2017. 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 2017/18	**Original Prudential Indicator**	**Revised Prudential Indicator**
Authorised Limit	£46m	£46m
Operational Boundary	£42m	£42m
Capital Financing Requirement (31.3.17)	£39m	£39m

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.

Prudential Indicator for Capital Expenditure

The table below shows the capital programme which was approved by the Authority 20th February 2017, it has since been revised to reflect the impact of capital expenditure and financing decisions in 2016/17.

Capital Expenditure 2017/18	**Approved Feb 2017 £000**	**Revised Estimate £000**	**Forecast Outturn £000**
Land & Buildings:			
Coventry Fire Station	5,100	4,954	2,500
Aston Fire Station	3,900	3,910	250
Training at Heights Facilities	0	317	326
Boiler Replacement Programme	264	264	105
Roof Replacements	66	66	66
Windows & Door Replacements	281	505	550
Rewires	55	332	260
Primary Control Room	500	600	600
X-Plan	376	0	0
Secondary Control Room Relocation	0	74	74
Vehicles:			
Vehicle Replacement Programme	2,530	3,130	2,380
ICT & Equipment:			
MDT Upgrade/Replacements	0	46	46
Oracle Licensing	0	25	0
Total	**13,072**	**14,223**	**7,157**

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 2017/18	Approved Feb 2017 £000	Revised Estimate £000	Forecast Outturn £000
Total Spend	**13,072**	**14,223**	**7,157**
Financed by:			
Capital Receipts	0	0	0
Capital Grants / Contributions	453	613	613
Revenue Contribution to Capital	12,619	13,610	6,544
Total Financing	**13,072**	**14,223**	**7,157**
Borrowing Need	**0**	**0**	**0**

Changes to the Prudential Indicators for the CFR, 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 – CFR
The Authority is on target to achieve the original forecast CFR.

Prudential Indicator – External Debt / the Operational Boundary

	2017/18 Original Estimate		2017/18 Revised Estimate
Prudential Indicator – CFR			
Total CFR (31.3.17)	£39m		£39m
Prudential Indicator – External Debt / the Operational Boundary			
Borrowing	£42m		£42m
Total debt 31 March 2017	£39m		£39m

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. Gross 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 2017/18 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.

	2017/18 Original Estimate	2017/18 Revised Estimate
Gross borrowing (Excluding Ex WMCC)	£35m	£35m
CFR (31.3.17)	£39m	£39m

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	2017/18 Original Indicator	2017/18 Revised Indicator
Borrowing	£46m	£46m

6. Investment Portfolio 2017/18

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 0.25% Bank Rate. The continuing potential for a re-emergence of a Eurozone sovereign debt crisis, and its impact on banks, prompts a low risk and short term strategy. Given this risk environment and that increases in Bank Rate are likely to be gradual and unlikely to return to the levels seen in previous decades, investment returns are likely to remain low.

The Authority held £73m of investments as at 30 September 2017 (£58m at 31 March 2017) and the investment portfolio yield for the first six months of the year is 0.232% against a benchmark (average 7-day LIBID rate) of 0.110%.

The Treasurer confirms that the approved limits within the Annual Investment Strategy were not breached during the first six months of 2017/18.

The Authority's budgeted investment return for 2017/18 is £0.175m, and performance for the year to date is in line with the budget.

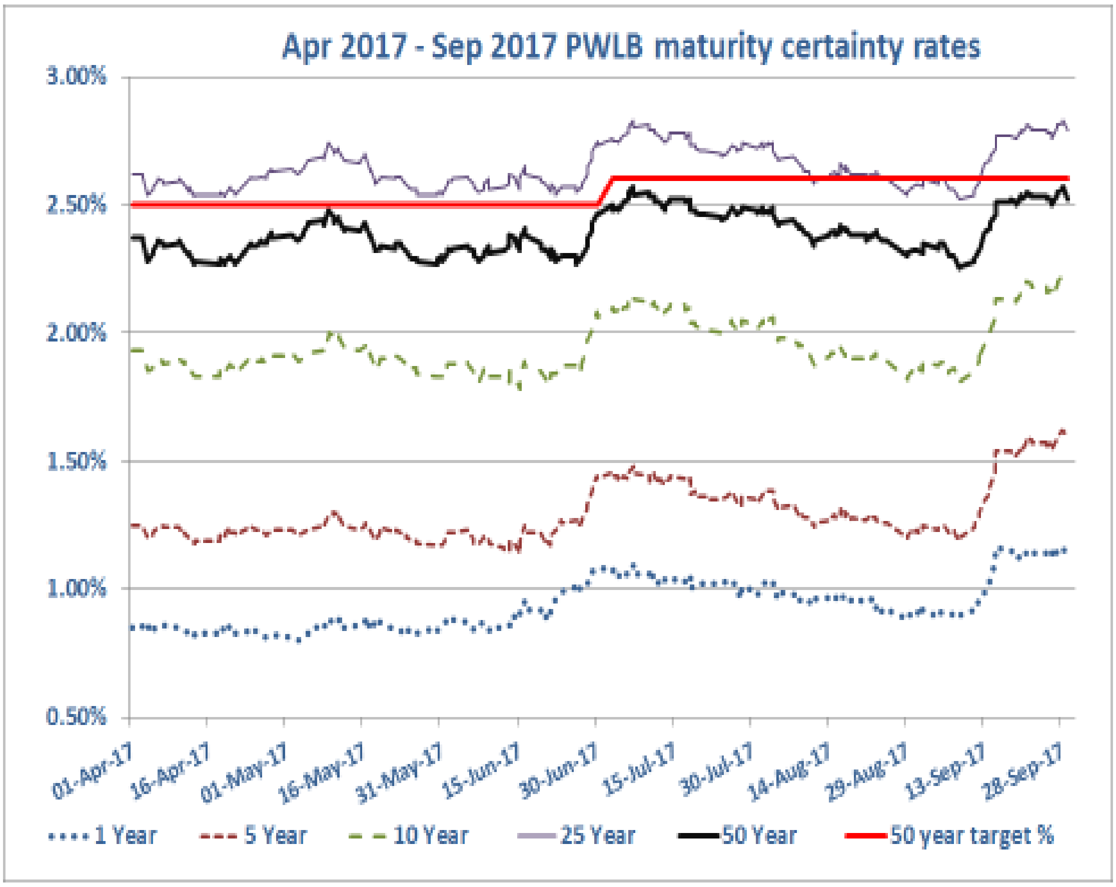
Investment Counterparty Criteria
The current investment counterparty criteria selection approved in the TMSS is meeting the requirement of the treasury management function.

7. Borrowing

The Authority's CFR for 2017/18 is £39m (31.3.17). 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 30.9.17):



8. Debt Rescheduling

No debt rescheduling was undertaken during the first six months of 2017/18. The Treasurer will continue to monitor opportunities for restructuring the Authority's debt during the remainder of the year.

9. Revised CIPFA Codes

CIPFA is currently conducting an exercise to consult local authorities on revising the Treasury Management Code and Cross Sectoral Guidance Notes, and the Prudential Code. CIPFA is aiming to issue the revised codes during November.

10. MIFID II

The EU has set a deadline of 3 January 2018 for the introduction of regulations under MIFID II. These regulations will govern the relationship that financial institutions conducting lending and borrowing transactions will have with local authorities from that date. This will have little effect on the Authority apart from having to complete forms sent by each institution dealing with the Authority and for each type of investment instrument used apart from for cash deposits with banks and building societies.