

WEST MIDLANDS FIRE SERVICE

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

Mid-year Review Report 2015/16

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 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.
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- 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 2015/16;
- 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 2015/16;
- A review of the Authority's borrowing strategy for 2015/16;
- A review of any debt rescheduling undertaken during 2015/16;
- A review of compliance with Treasury and Prudential Limits for 2015/16.

3. Economic update

Economic performance to date and outlook

UK: UK GDP growth rates in 2013 of 2.2% and 2.9% in 2014 were the strongest growth rates of any G7 country; the 2014 growth rate was also the strongest UK rate since 2006 and the 2015 growth rate is likely to be a leading rate in the G7 again, possibly being equal to that of the US. However, quarter 1 of 2015 was weak at +0.4% (+2.9% y/y) though there was a rebound in quarter 2 to +0.7% (+2.4% y/y). Growth is expected to weaken to about +0.5% in quarter 3 as the economy faces headwinds for exporters from the appreciation of Sterling against the Euro and weak growth in the European Union (EU), China and emerging markets, plus the dampening effect of the Government's continuing austerity programme, although the pace of reductions was eased in the May Budget. Despite these headwinds, the Bank of England August Inflation Report had included a forecast for growth to remain around 2.4 – 2.8% over the next three years, driven mainly by strong consumer demand as the squeeze on the disposable incomes of consumers has been reversed by a recovery in wage inflation at the same time that CPI inflation has fallen to, or near to, zero over the last quarter. Investment expenditure is also expected to support growth. However, since

the report was issued, the Purchasing Manager's Index, (PMI), for services on 5 October would indicate a further decline in the growth rate to only +0.3% in Q4, which would be the lowest rate since the end of 2012. In addition, worldwide economic statistics and UK consumer and business confidence have distinctly weakened so it would therefore not be a surprise if the next Inflation Report in November were to cut those forecasts in August.

The August Bank of England Inflation Report forecast was notably subdued in respect of inflation which was forecast to barely get back up to the 2% target within the 2-3 year time horizon. However, with the price of oil taking a fresh downward direction and Iran expected to soon rejoin the world oil market after the impending lifting of sanctions, there could be several more months of low inflation still to come, especially as world commodity prices have generally been depressed by the Chinese economic downturn.

There are therefore considerable risks around whether inflation will rise in the near future as strongly as had previously been expected; this will make it more difficult for the central banks of both the US and the UK to raise rates as soon as was being forecast until recently, especially given the recent major concerns around the slowdown in Chinese growth, the knock on impact on the earnings of emerging countries from falling oil and commodity prices, and the volatility we have seen in equity and bond markets in 2015 so far, which could potentially spill over to impact the real economies rather than just financial markets.

Eurozone: The European Central Bank (ECB) announced a massive €1.1 trillion programme of quantitative easing (QE) in January 2015 to buy up high credit quality government debt of selected Eurozone countries. This programme started in March and will run to September 2016. This seems to have already had a beneficial impact in improving confidence and sentiment. There has also been a continuing trend of marginal increases in the GDP growth rate which hit 0.4% in quarter 1 2015 (1.0% y/y) and +0.4%, (1.5% y/y) in Q2 GDP. The ECB has also stated it would extend its QE programme if inflation failed to return to its target of 2% within this initial time period.

Greece. During July, Greece finally capitulated to EU demands to implement a major programme of austerity and is now cooperating with EU demands. An €86bn third bailout package has since been agreed though it did nothing to address the unsupportable size of total debt compared to GDP. However, huge damage has been done to the Greek banking system and economy by the resistance of the Syriza Government, elected in January, to EU demands. The surprise general election in September gave the Syriza government a mandate to stay in power to implement austerity measures. However, there are major doubts as to whether the size of cuts and degree of reforms required can be fully implemented and so Greek exit from the euro may only have been delayed by this latest bailout.

Capita Asset Services interest rate forecast

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

	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18
Bank rate	0.50%	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%	1.50%	1.50%	1.75%	1.75%
5yr PWLB rate	2.40%	2.50%	2.60%	2.80%	2.90%	3.00%	3.10%	3.20%	3.30%	3.40%	3.50%
10yr PWLB rate	3.00%	3.20%	3.30%	3.40%	3.50%	3.70%	3.80%	3.90%	4.00%	4.10%	4.20%
25yr PWLB rate	3.60%	3.80%	3.90%	4.00%	4.10%	4.20%	4.30%	4.40%	4.50%	4.60%	4.60%
50yr PWLB rate	3.60%	3.80%	3.90%	4.00%	4.10%	4.20%	4.30%	4.40%	4.50%	4.60%	4.60%

Capita Asset Services undertook its last review of interest rate forecasts on 11 August shortly after the quarterly Bank of England Inflation Report. Later in August, fears around the slowdown in China and Japan caused major volatility in equities and bonds and sparked a flight from equities into safe havens like gilts and so caused Public Works Loan Board (PWLB) rates to fall below the above forecasts for quarter 4 2015. However, there is much volatility in rates as news ebbs and flows in negative or positive ways and news in September in respect of Volkswagen, and other corporates, has compounded downward pressure on equity prices. This latest forecast includes a first increase in Bank Rate in quarter 2 of 2016.

Despite market turbulence since late August causing a sharp downturn in PWLB rates, the overall trend in the longer term will be for gilt yields and PWLB rates to rise when economic recovery is firmly established accompanied by rising inflation and consequent increases in Bank Rate, and the eventual unwinding of QE. Increasing investor confidence in eventual world economic recovery is also likely to compound this effect as recovery will encourage investors to switch from bonds to equities.

4. Treasury Management Strategy Statement and Annual Investment Strategy update

The Treasury Management Strategy Statement (TMSS) for 2015/16 was approved by the Authority on 16th February 2015. 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 2015/16	Original Prudential Indicator	Revised Prudential Indicator
Authorised Limit	£48m	£48m
Operational Boundary	£44m	£44m
Capital Financing Requirement (31.3.15)	£41m	£41m

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 16th February 2015, it has since been revised to reflect the impact of capital expenditure and financing decisions in 2014/15.

Capital Expenditure 2015/16	Approved Feb 2015 £000	Revised Estimate £000	Forecast Outturn £000
Land & Buildings:			
Haden Cross Fire Station	50	126	146
Drill Towers / Training Facilities Upgrade	130	363	363
Boiler Replacement Programme	229	229	185
Roof Replacements	108	108	48
Windows & Door Replacements	124	269	317
Rewires	55	120	55
Dignity at Work	90	407	390
Asbestos Removal	-	27	42
Aston/Coventry Fire Station	-	-	5
Fire Control Relocation	-	7	7
Vehicles:			
Vehicle Replacement Programme	2,865	3,108	3,108
ICT & Equipment:			
MDT Upgrade/Replacements	268	310	310
Fire Control C&C Upgrade	-	167	167
Other Equipment	-	5	5
Thermal Image Cameras	-	138	128
Oracle Licensing	-	25	-
Pensions System Replacement	-	23	1
Total	3,919	5,432	5,277

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 2015/16	Approved Feb 2015 £000	Revised Estimate £000	Forecast Outturn £000
Total Spend	3,919	5,432	5,277
Financed by:			
Capital Receipts	-	-	-
Capital Grants	3,000	4,905	4,905
Revenue Contribution to Capital	919	527	372
Total Financing	3,919	5,432	5,277
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

	2015/16 Original Estimate		2015/16 Revised Estimate
Prudential Indicator – CFR			
Total CFR (31.3.15)	£41m		£41m
Prudential Indicator – External Debt / the Operational Boundary			
Borrowing	£44m		£44m
Total debt 31 March 2015	£41m		£41m

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 2015/16 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.

	2015/16 Original Estimate	2015/16 Revised Estimate
Gross borrowing (Excluding Ex WMCC)	£37m	£37m
CFR (31.3.15)	£41m	£41m

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	2015/16 Original Indicator	2015/16 Revised Indicator
Borrowing	£48m	£48m

6. Investment Portfolio 2015/16

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 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, investment returns are likely to remain low.

The Authority held £76m of investments as at 30 September 2015 (£65m at 31 March 2015) and the investment portfolio yield for the first six months of the year is 0.41% 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 2015/16.

The Authority's budgeted investment return for 2015/16 is £0.265m, and performance for the year to date is in line with the budget.

Investment Counterparty Criteria

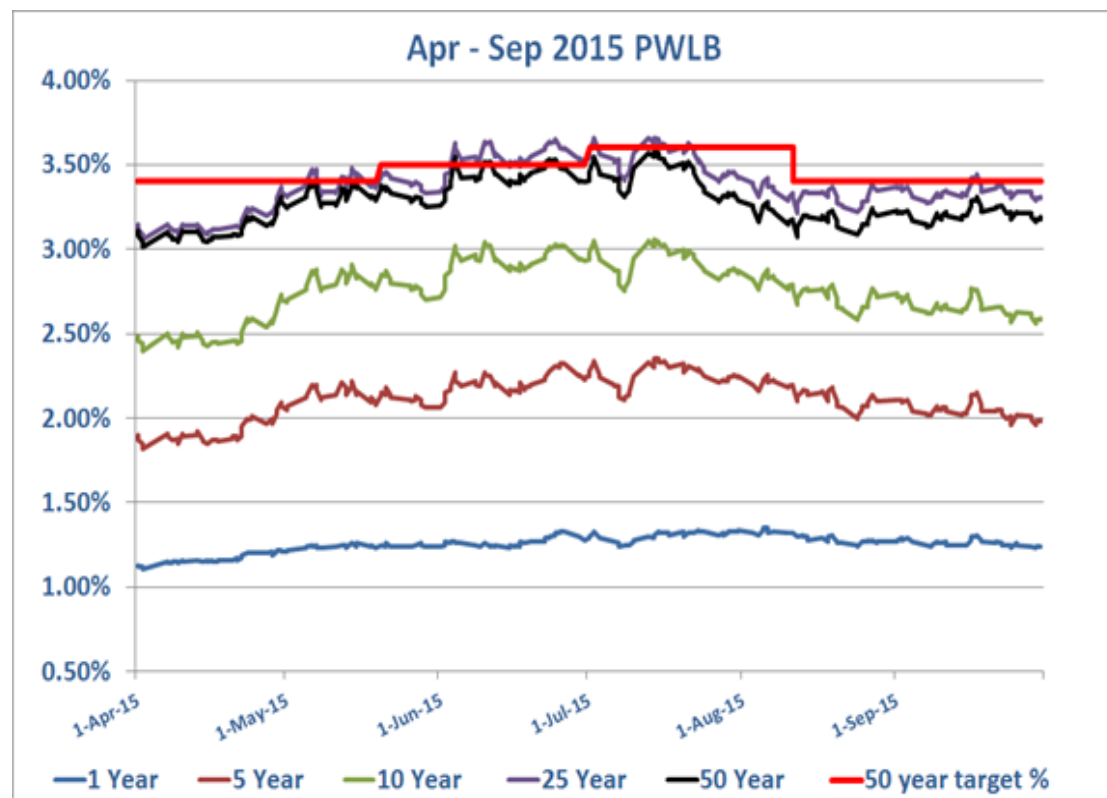
The current investment counterparty criteria selection approved in the TMSS is meeting the requirement of the treasury management function.

7. Borrowing

The Authority's CFR for 2015/16 is £41m (31.3.15). 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 30.9.15):



8. Debt Rescheduling

No debt rescheduling was undertaken during the first six months of 2015/16. The Treasurer will continue to monitor opportunities for restructuring the Authority's debt during the remainder of the year.