

WEST MIDLANDS FIRE SERVICE



Treasury Management Strategy Statement and Annual Investment Strategy

Mid-year Review Report 2016/17

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.
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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 2016/17;
- 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 2016/17;
- A review of the Authority's borrowing strategy for 2016/17;
- A review of any debt rescheduling undertaken during 2016/17;
- A review of compliance with Treasury and Prudential Limits for 2016/17

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 strong but 2015 was disappointing at 1.8%, though it still remained one of the leading rates among the G7 countries. Growth improved in quarter 4 of 2015 from +0.4% to 0.7% but fell back to +0.4% (2.0% y/y) in quarter 1 of 2016 before bouncing back again to +0.7% (2.1% y/y) in quarter 2. During most of 2015, the economy had faced headwinds for exporters from the appreciation during the year of sterling against the Euro, and weak growth in the EU, China and emerging markets, plus the dampening effect of the Government's continuing austerity programme. The referendum vote for Brexit in June this year delivered an immediate shock fall in confidence indicators and business surveys, pointing to an impending sharp slowdown in the economy. However, subsequent surveys have shown a sharp recovery in confidence and business surveys, though it is generally expected that although the economy will now avoid flat lining, growth will be weak through the second half of 2016 and in 2017.

The Bank of England meeting on August 4th addressed this expected slowdown in growth by a package of measures including a cut in Bank Rate from 0.50% to

0.25%. The Inflation Report included an unchanged forecast for growth for 2016 of 2.0% but cut the forecast for 2017 from 2.3% to just 0.8%. The Governor of the Bank of England, Mark Carney, had warned that a vote for Brexit would be likely to cause a slowing in growth, particularly from a reduction in business investment, due to the uncertainty of whether the UK would have continuing full access, (i.e. without tariffs), to the EU single market. He also warned that the Bank could not do all the heavy lifting and suggested that the Government will need to help growth by increasing investment expenditure and possibly by using fiscal policy tools (taxation). The new Chancellor Phillip Hammond announced after the referendum result, that the target of achieving a budget surplus in 2020 will be eased in the Autumn Statement on November 23.

The Inflation Report also included a sharp rise in the forecast for inflation to around 2.4% in 2018 and 2019. CPI has started rising during 2016 as the falls in the price of oil and food twelve months ago fall out of the calculation during the year and, in addition, the post referendum 10% fall in the value of sterling on a trade weighted basis is likely to result in a 3% increase in CPI over a time period of 3-4 years. However, the MPC is expected to look thorough a one off upward blip from this devaluation of sterling in order to support economic growth, especially if pay increases continue to remain subdued and therefore pose little danger of stoking core inflationary price pressures within the UK economy.

USA: The American economy had a patchy 2015 with sharp swings in the growth rate leaving the overall growth for the year at 2.4%. Quarter 1 of 2016 disappointed at +0.8% on an annualised basis while quarter 2 improved, but only to a lacklustre +1.4%. However, forward indicators are pointing towards a pickup in growth in the rest of 2016. The Fed. embarked on its long anticipated first increase in rates at its December 2015 meeting. At that point, confidence was high that there would then be four more increases to come in 2016. Since then, more downbeat news on the international scene and then the Brexit vote, have caused a delay in the timing of the second increase which is now strongly expected in December this year.

Europe: In the Eurozone, the ECB commenced in March 2015 its massive €1.1 trillion programme of quantitative easing to buy high credit quality government and other debt of selected EZ countries at a rate of €60bn per month; this was intended to run initially to September 2016 but was extended to March 2017 at its December 2015 meeting. At its December and March meetings it progressively cut its deposit facility rate to reach -0.4% and its main refinancing rate from 0.05% to zero. At its March meeting, it also increased its monthly asset purchases to €80bn. These measures have struggled to make a significant impact in boosting economic growth and in helping inflation to rise from around zero towards the target of 2%. GDP growth rose by 0.6% in quarter 1 2016 (1.7% y/y) but slowed to +0.3% (+1.6% y/y) in quarter 2. This has added to comments from many forecasters that central banks around the world are running out of ammunition to stimulate economic growth and to boost inflation. They stress that national governments will need to do more by way of structural reforms, fiscal measures and direct investment expenditure to support demand in the their economies and economic growth.

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	Jun-20
Bank Rate	0.75%	0.50%	0.25%	0.10%	0.10%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%
6m+ PWLB rate	1.00%	1.00%	1.10%	1.10%	1.10%	1.10%	1.20%	1.20%	1.20%	1.20%	1.20%
12m+ PWLB rate	1.20%	1.00%	1.00%	1.00%	1.00%	1.00%	1.10%	1.10%	1.10%	1.10%	1.10%
30yr PWLB rate	2.30%	2.30%	2.40%	2.40%	2.40%	2.40%	2.50%	2.50%	2.50%	2.50%	2.50%
50yr PWLB rate	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%

Capita Asset Services undertook a quarterly review of its interest rate forecasts after the MPC meeting of 4th August cut Bank Rate to 0.25% and gave forward guidance that it expected to cut Bank Rate again to near zero before the year end. The above forecast therefore includes a further cut to 0.10% in November this year and a first increase in May 2018, to 0.25%, but no further increase to 0.50% until a year later. Mark Carney, has repeatedly stated that increases in Bank Rate will be slow and gradual after they do start. The MPC is concerned about the impact of increases on many heavily indebted consumers, especially when the growth in average disposable income is still weak and could well turn negative when inflation rises during the next two years to exceed average pay increases.

The overall longer run trend is for gilt yields and PWLB rates to rise, albeit gently. An eventual world economic recovery may also see investors switching from the safe haven of bonds to equities. However, we have been experiencing exceptional levels of volatility in financial markets which have caused significant swings in PWLB rates.

4. Treasury Management Strategy Statement and Annual Investment Strategy update

The Treasury Management Strategy Statement (TMSS) for 2016/17 was approved by the Authority on 15th February 2016. 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 2016/17	Original Prudential Indicator	Revised Prudential Indicator
Authorised Limit	£47m	£47m
Operational Boundary	£43m	£43m
Capital Financing Requirement (31.3.16)	£40m	£40m

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 15th February 2016, it has since been revised to reflect the impact of capital expenditure and financing decisions in 2015/16.

Capital Expenditure 2016/17	Approved Feb 2016 £000	Revised Estimate £000	Forecast Outturn £000
Land & Buildings:			
Coventry Fire Station	2,500	2,412	2,412
Aston Fire Station	200	191	50
Training at Heights Facilities	363	363	363
Boiler Replacement Programme	303	306	306
Roof Replacements	132	132	14
Windows & Door Replacements	131	131	131
Rewires	145	210	210
Dignity at Work	0	4	4
Haden Cross Fire Station	0	49	50
X-Plan	300	299	299
Bilston Modification Works	90	90	88
Secondary Control Room Relocation	0	500	500
Vehicles:			
Vehicle Replacement Programme	2,318	3,007	2,476
ICT & Equipment:			
MDT Upgrade/Replacements	0	310	300
Oracle Licensing	0	25	25
PBX Upgrade	0	54	54
Total	6,482	8,083	7,282

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 2016/17	Approved Feb 2016 £000	Revised Estimate £000	Forecast Outturn £000
Total Spend	6,482	8,083	7,282
Financed by:			
Capital Receipts	1,105	1,105	1,105
Capital Grants / Contributions	1,025	2,635	2,635
Revenue Contribution to Capital	4,352	4,343	3,542
Total Financing	6,482	8,083	7,282
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

	2016/17 Original Estimate	2016/17 Revised Estimate
Prudential Indicator – CFR		
Total CFR (31.3.16)	£40m	£40m
Prudential Indicator – External Debt / the Operational Boundary		
Borrowing	£43m	£43m
Total debt 31 March 2016	£40m	£40m

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 2016/17 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.

	2016/17 Original Estimate	2016/17 Revised Estimate
Gross borrowing (Excluding Ex WMCC)	£36m	£36m
CFR (31.3.16)	£40m	£40m

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	2016/17 Original Indicator	2016/17 Revised Indicator
Borrowing	£47m	£47m

6. Investment Portfolio 2016/17

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, investment returns are likely to remain low.

The Authority held £76m of investments as at 30 September 2016 (£56m at 31 March 2016) 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 0.28%.

The Treasurer confirms that the approved limits within the Annual Investment Strategy were not breached during the first six months of 2016/17.

The Authority's budgeted investment return for 2016/17 is £0.2m, and performance for the year to date is in line with the budget.

Investment Counterparty Criteria

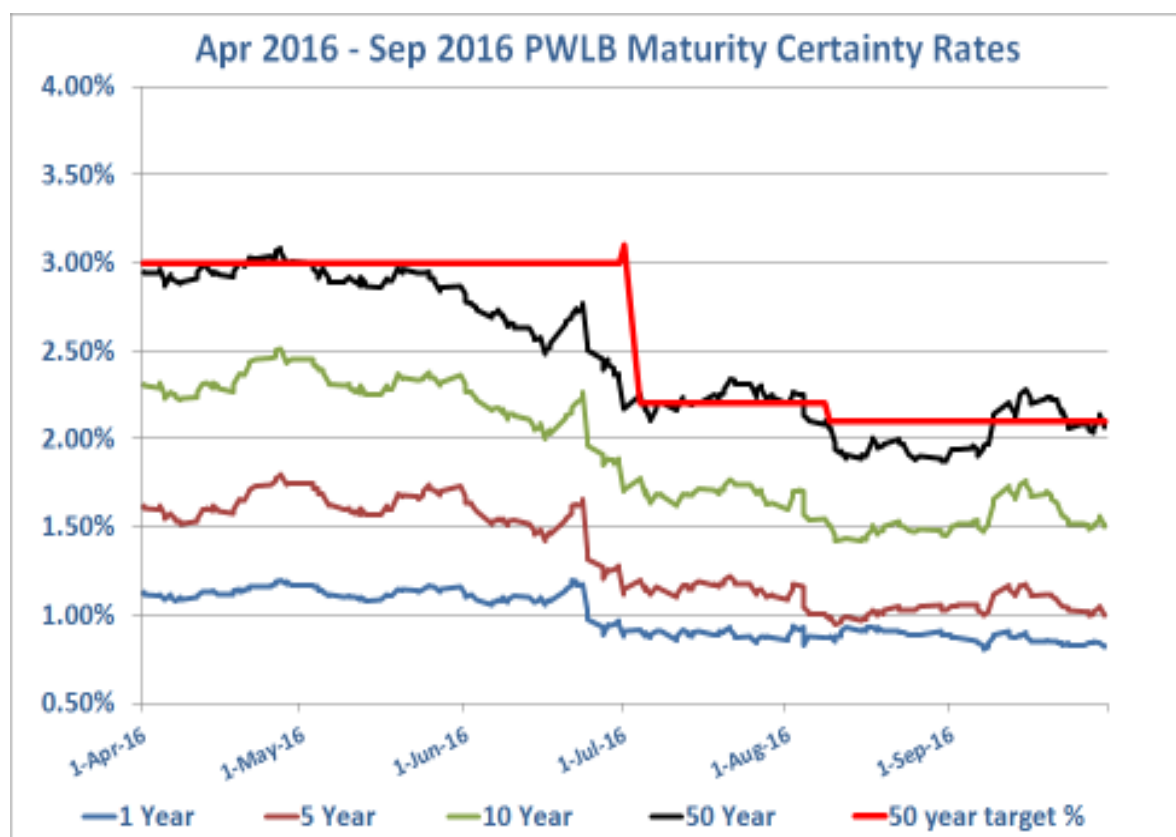
The current investment counterparty criteria selection approved in the TMSS is meeting the requirement of the treasury management function.

7. Borrowing

The Authority's CFR for 2016/17 is £40m (31.3.16). 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 30.9.16):



8. Debt Rescheduling

No debt rescheduling was undertaken during the first six months of 2016/17. The Treasurer will continue to monitor opportunities for restructuring the Authority's debt during the remainder of the year.