WEST MIDLANDS FIRE AND RESCUE AUTHORITY

AUDIT AND RISK COMMITTEE

27 JULY 2020

1. TREASURY MANAGEMENT – ANNUAL REPORT 2019/2020

Report of the 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 2019/2020 Treasury Management Strategy Statement and Annual Investment Strategy and its Prudential indicators in February 2019. 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 2019/2020 and the actual Prudential Indicators for 2019/2020.

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 2019/2020.

3.2 Appendix A, the Annual Treasury Management Report 2019/2020 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 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.

7. **ENVIRONMENTAL IMPLICATIONS**

There are no environmental implications arising from this report.

BACKGROUND PAPERS

Authority's Budget and Precept Report – February 2019
Treasury Management Mid-Year Report – Audit and Risk Committee November 2019
Link Treasury Services – Treasury Management Bulletins and Newsletters

The contact officer for this report is Deputy Chief Fire Officer Wayne Brown, telephone number 0121 380 6907.

MIKE GRIFFITHS
TREASURER

APPENDIX A

Annual Treasury Management Review
2019/20

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 2019/20. 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 2019/20 the minimum reporting requirements were that the Authority should receive the following reports:

- an annual treasury strategy in advance of the year (Authority 18/02/2019)
- a mid-year treasury update report (Audit Committee 11/11/2019)
- 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 2019/20 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	2018/19	2019/20
Actual capital expenditure	£8.890m	£5.283m
Total Capital Financing Requirement	£37.143m	£36.259m
Financing costs to net revenue stream	2.4%	2.5%

The Treasurer confirms that no borrowing was undertaken for any capital purpose during 2019/20 and that the statutory borrowing limit (the authorised limit), was not breached.

As at 31st March 2020, the Authority's external debt was £35.697m (£36.002m as at 31st March 2019) and its investment totalled £45.583m (£40.904m as at 31st March 2019).

2. The Economy and Interest Rates

UK Brexit. The main issue in 2019 was for the House of Commons to agree on a way forward for the UK over the issue of Brexit. This resulted in the resignation of Teresa May as the leader of the Conservative minority Government and the election of Boris Johnson as the new leader, on a platform of taking the UK out of the EU on 31 October 2019. The House of Commons duly frustrated that renewed effort and so a general election in December settled the matter once and for all by a decisive victory for the Conservative Party: that then enabled the UK to leave the EU on 31 January 2020. However, this still leaves much uncertainty as to whether there will be a reasonable trade deal achieved by the target deadline of the end of 2020. It is also unclear as to whether the coronavirus outbreak may yet impact on this deadline; however, the second and third rounds of negotiations have already had to be cancelled due to the virus.

Economic growth in 2019 has been very volatile with quarter 1 unexpectedly strong at 0.5%, quarter 2 dire at -0.2%, quarter 3 bouncing back up to +0.5% and quarter 4 flat at 0.0%, +1.1% y/y. 2020 started with optimistic business surveys pointing to an upswing in growth after the ending of political uncertainty as a result of the decisive result of the general election in December settled the Brexit issue. However, the three-monthly GDP statistics in January were disappointing, being stuck at 0.0% growth. Since then, the whole world has changed as a result of the coronavirus outbreak. It now looks likely that the closedown of whole sections of the economy will result in a fall in GDP of at least 15% in quarter two. What is uncertain, however, is the extent of the damage that will be done to businesses by the end of the lock down period, when the end of the lock down will occur, whether there could be a second wave of the outbreak, how soon a vaccine will be created and then how quickly it can be administered to the population. This leaves huge uncertainties as to how quickly the economy will recover.

After the Monetary Policy Committee raised Bank Rate from 0.5% to 0.75% in August 2018, Brexit uncertainty resulted in the MPC doing nothing until March 2020; at this point it was abundantly clear that the coronavirus outbreak posed a huge threat to the economy of the UK. Two emergency cuts in Bank Rate from 0.75% occurred in March, first to 0.25% and then to 0.10%. These cuts were accompanied by an increase in quantitative easing (QE), essentially the purchases of gilts (mainly) by the Bank of England of £200bn. The Government and the Bank were also very concerned to stop people losing their jobs during this lockdown period. Accordingly, the Government introduced various schemes to subsidise both employed and self-employed jobs for three months while the country is locked down. It also put in place a raft of other measures to help businesses access loans from their banks, (with the Government providing guarantees to the banks against losses), to tide them over the lock down period when some firms may have little or no income. However, at the time of writing, this leaves open a question as to whether some firms will be solvent, even if they take out such loans, and some may also choose to close as there is, and will be, insufficient demand for their services. At the time of writing, this is a rapidly evolving situation so there may be further measures to come from the Bank and the Government. The measures to support jobs and businesses already taken by the Government will result in a huge increase in the annual budget deficit in 2020/21 from 2%, to nearly 11%. The ratio of debt to GDP is also likely to increase from 80% to around 105%. In the Budget in March, the Government also announced a large increase in spending on infrastructure; this will also help the economy to recover once the lockdown is ended. Provided the coronavirus outbreak is brought under control relatively swiftly, and the lockdown is eased, then it is hoped that there would be a sharp recovery, but one that would take a prolonged time to fully recover previous lost momentum.

Inflation has posed little concern for the MPC during the last year, being mainly between 1.5 – 2.0%. It is also not going to be an issue for the near future as the world economy will be heading into a recession which is already causing a glut in the supply of oil which has fallen sharply in price. Other prices will also be under downward pressure while wage inflation has also been on a downward path over the last half year and is likely to continue that trend in the current environment. While inflation could even turn negative in the Eurozone, this is currently not likely in the UK.

Employment had been growing healthily through the last year but is now heading for a hit in 2020. The good news over the last year is that wage inflation has been significantly higher than CPI inflation which means that consumer real spending power had been increasing and so will have provided support to GDP growth. However, while people cannot leave their homes to do non-food shopping, retail sales will also take a big hit.

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.

	2018/19 Actual £m	2019/20 Actual £m
Total capital expenditure	**8.809**	**5.283**
Resourced by:		
• Capital receipts	0.000	0.000
• Capital grants	0.660	0.083
• Revenue Contribution to Capital	8.149	5.200
Capital Expenditure Financed from Borrowing	**0**	**0**

4. Overall Treasury Position as at 31 March 2020

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 2019/20 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 2019/20 was approved 18 February 2019.

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

CFR	31 March 2019 Actual £m	31 March 2020 Actual £m
Opening balance	37.977	37.143
Add unfinanced capital expenditure	0	0
Less MRP	(0.834)	(0.884)
Less VRP	0	0
Closing balance	37.143	36.259

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

Gross borrowing and the CFR - in order to ensure that borrowing levels are prudent over the medium term and only for a capital purpose, the Authority should ensure that its gross external borrowing does not, except in the short term, exceed the total of the capital financing requirement in the preceding year (2019/20) plus the estimates of any additional capital financing requirement for the current (2020/21) and next two financial years. This essentially means that the Authority is not borrowing to support revenue expenditure. This indicator allows the Authority some flexibility to borrow in advance of its immediate capital needs in 2019/20.

	31 March 2019 Actual £m	31 March 2020 Actual £m
External Debt	36.002	35.697
Investments	40.904	45.583
Net Borrowing Position	(4.902)	(9.886)
CFR	37.143	36.259

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 2019/20 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.

	2018/19	**2019/20**
Authorised limit	£45m	£44m
Operational boundary	£41m	£40m
Maximum gross borrowing position	£38m	£37m
Financing costs as a proportion of net revenue stream	2.4%	2.5%

5. Overall Treasury Position as at 31 March 2020

The Authority's investment position is organised with the treasury management service at Sandwell MBC, 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 2019/20 the Authority's position was as follows:

	31 March 2019 Principal £m	**Rate/ Return**	**31 March 2020 Principal £m**	**Rate/ Return**
Fixed Rate Loans:				
PWLB	*£33.1*	*5.3%*	*£33.1*	*5.3%*
Ex WMCC	*£2.9*	*5.6%*	*£2.6*	*5.6%*
Total Debt	*£36.0*	*5.4%*	*£35.7*	*5.4%*
CFR	*£37.1*		*£36.3*	
Over / (under) borrowing	*(£1.1)*		*(£0.6)*	
Investments:				
Sandwell MBC	*£40.9*	*0.7%*	*£45.6*	*0.9%*
Net Debt	(£4.9)		(£9.9)	

The maturity structure of the debt portfolio was as follows:

	31 March 2019 Actual £m	**31 March 2020 Actual £m**
Under 12 months	305	1.992
12 months and within 24 months	2.022	2.476
24 months and within 5 years	3.836	1.685
5 years and within 10 years	3.139	2.834
10 years and above	26.700	26.700

6. The Strategy for 2019/20

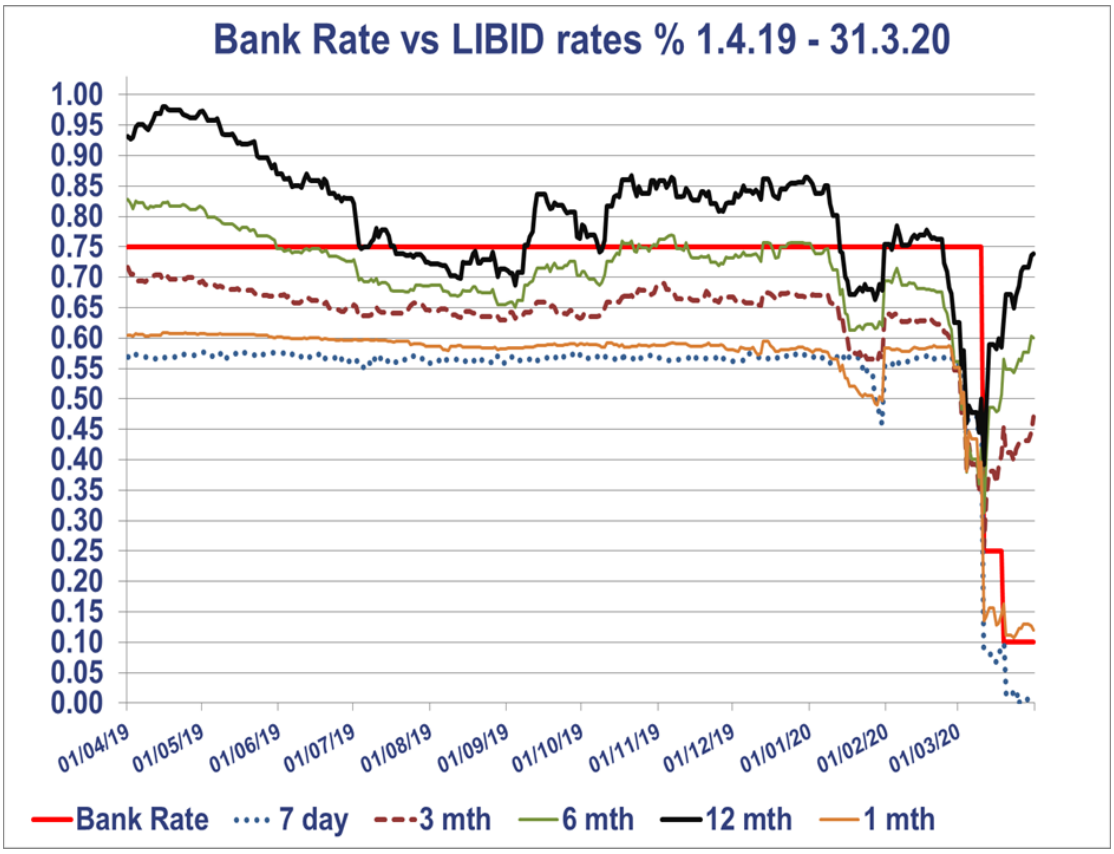
Investment returns remained low during 2019/20. The expectation for interest rates within the treasury management strategy for 2019/20 was that Bank Rate would stay at 0.75% during 2019/20 as it was not expected that the MPC would be able to deliver on an increase in Bank Rate until the Brexit issue was finally settled. However, there was an expectation that Bank Rate would rise after that issue was settled but would only rise to 1.0% during 2020.

Rising concerns over the possibility that the UK could leave the EU at the end of October 2019 caused longer term investment rates to be on a falling trend for most of April to September. They then rose after the end of October deadline was rejected by the Commons but fell back again in January before recovering again after the 31 January departure of the UK from the EU. When the coronavirus outbreak hit the UK in February/March, rates initially plunged but then rose sharply back up again due to a shortage of liquidity in financial markets. As longer term rates were significantly higher than shorter term rates during the year, value was therefore sought by placing longer term investments where cash balances were sufficient to allow this.

While the Authority has taken a cautious approach to investing, it is also fully appreciative of changes to regulatory requirements for financial institutions in terms of additional capital and liquidity that came about in the aftermath of the financial crisis. These requirements have provided a far stronger basis for financial institutions, with annual stress tests by regulators evidencing how institutions are now far more able to cope with extreme stressed market and economic conditions.

Investment balances have been kept to a minimum through the agreed strategy of using reserves and balances to support internal borrowing, rather than borrowing externally from the financial markets. External borrowing would have incurred an additional cost, due to the differential between borrowing and investment rates. Such an approach has also provided benefits in terms of reducing the counterparty risk exposure, by having fewer investments placed in the financial markets.

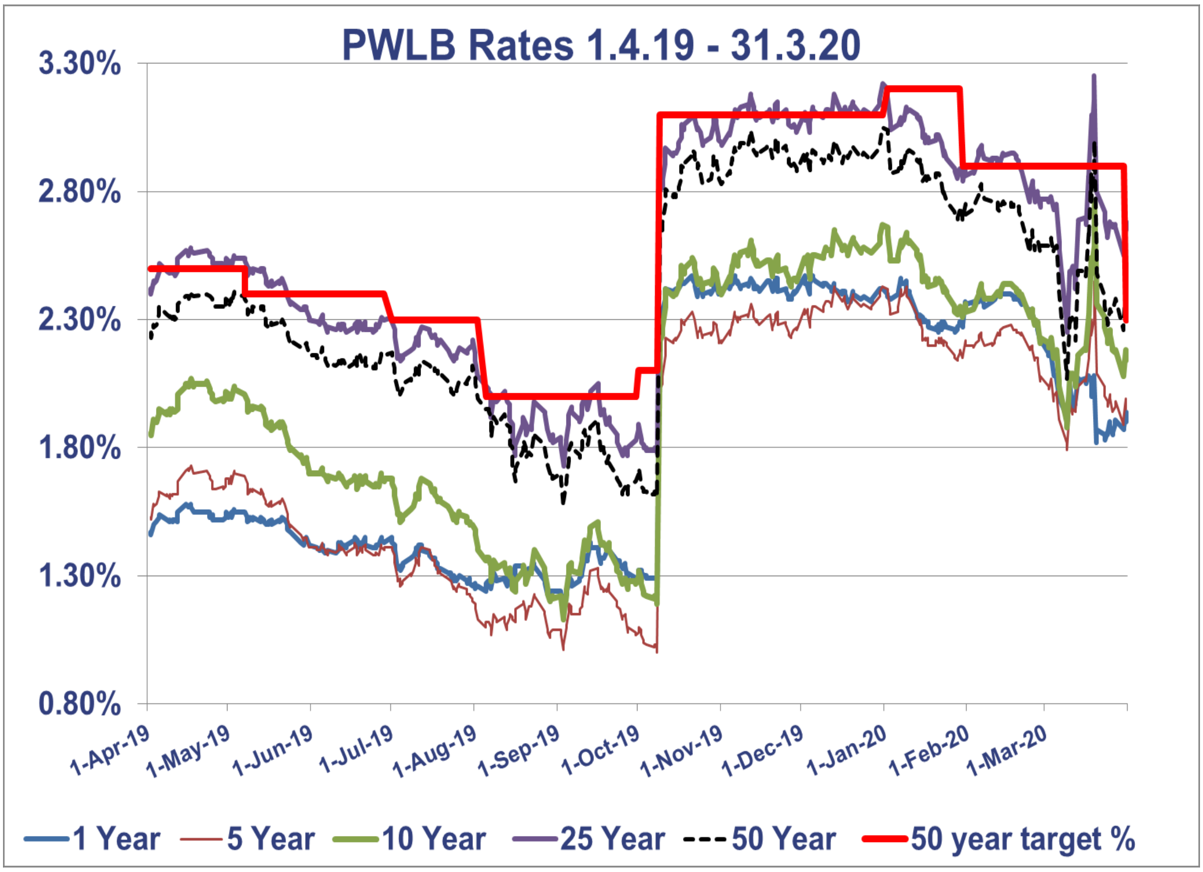
Investment strategy and control of interest rate risk



	Bank Rate	7 day	1 mth	3 mth	6 mth	12 mth
High	0.75	0.58	0.61	0.72	0.83	0.98
High Date	01/04/2019	09/05/2019	15/04/2019	01/04/2019	01/04/2019	15/04/2019
Low	0.10	0.00	0.11	0.26	0.31	0.39
Low Date	19/03/2020	25/03/2020	23/03/2020	11/03/2020	11/03/2020	11/03/2020
Average	0.72	0.53	0.56	0.63	0.70	0.80
Spread	0.65	0.58	0.50	0.46	0.52	0.59

7. Borrowing Rates in 2019/20

The graphs for PWLB rates show, for a selection of maturity periods, the average borrowing rates, the high and low points in rates, spreads and individual rates at the start and the end of the financial year.



8. **Borrowing Outturn for 2019/20**

Borrowing – No borrowing was undertaken during 2019/20.

Rescheduling – No rescheduling was undertaken during 2019/20.

9. Investment Outturn for 2019/20

Investment Policy – the Authority's investment policy is governed by MHCLG guidance, which was been implemented in the annual investment strategy approved by the Authority on 18 February 2019. 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 £48.9m of internally managed funds. The internally managed funds earned an average rate of return of 0.87%. The comparable performance indicator is the average 7-day LIBID rate, which was 0.54%. This compares with a budget assumption of £47m investment balances earning an average rate of 0.85%.