APPENDIX A

WEST MIDLANDS FIRE SERVICE

Annual Treasury Management Review
2015/16

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 2015/16. 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 2015/16 the minimum reporting requirements were that the Authority should receive the following reports:

- an annual treasury strategy in advance of the year (Authority 16/02/2015)
- a mid-year treasury update report (Audit Committee 09/11/2015)
- 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 2015/16 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	2014/15	2015/16
Actual capital expenditure	£3.036m	£3.075m
Total Capital Financing Requirement	£40.211m	£39.508m
Financing costs to net revenue stream	3.63%	2.84%

The Treasurer confirms that no borrowing was undertaken for any capital purpose during 2015/16 and that the statutory borrowing limit (the authorised limit), was not breached.

As at 31st March 2016, the Authority's external debt was £39.700m (£40.751m as at 31st March 2015) and its investment totalled £54.12m (£64.4m as at 31st March 2015).

2. The Economy and Interest Rates

Market expectations for the first increase in Bank Rate moved considerably during 2015/16, starting at quarter 3 2015 but soon moving back to quarter 1 2016. However, by the end of the year, market expectations had moved back radically to quarter 2 2018 due to many fears including concerns that China's economic growth could be heading towards a hard landing; the potential destabilisation of some emerging market countries particularly exposed to the Chinese economic slowdown; and the continuation of the collapse in oil prices during 2015 together with continuing Eurozone growth uncertainties.

These concerns have caused sharp market volatility in equity prices during the year with corresponding impacts on bond prices and bond yields due to safe haven flows. Bank Rate, therefore, remained unchanged at 0.5% for the seventh successive year. Economic growth (GDP) in 2015/16 has been disappointing with growth falling steadily from an annual rate of 2.9% in quarter 1 2015 to 2.1% in quarter 4.

The sharp volatility in equity markets during the year was reflected in sharp volatility in bond yields. However, the overall dominant trend in bond yields since July 2015 has been for yields to fall to historically low levels as forecasts for inflation have repeatedly been revised downwards and expectations of increases in central rates have been pushed back. In addition, a notable trend in the year was that several central banks introduced negative interest rates as a measure to stimulate the creation of credit and hence economic growth.

The ECB commenced a full blown quantitative easing programme of purchases of Eurozone government and other bonds starting in March at €60bn per month. This put downward pressure on Eurozone bond yields. There was a further increase in this programme of QE in December 2015.

As for America, the economy has continued to grow healthily on the back of resilient consumer demand. The first increase in the central rate occurred in December 2015 since when there has been a return to caution as to the speed of further increases due to concerns around the risks to world growth.

The UK elected a majority Conservative Government in May 2015, removing one potential concern but introducing another due to the promise of a referendum on the UK remaining part of the EU. The government maintained its tight fiscal policy stance but the more recent downturn in expectations for economic growth has made it more difficult to return the public sector net borrowing to a balanced annual position within the period of this parliament.

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.

	2014/15 Actual £m	2015/16 Actual £m
Total capital expenditure	**3.036**	**3.075**
Resourced by:		
• Capital receipts	0	0
• Capital grants	3.036	3.075
• Revenue Contribution to Capital	0	0
Capital Expenditure Financed from Borrowing	**0**	**0**

4. Overall Treasury Position as at 31 March 2016

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 2015/16 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 2015/16 was approved 16th February 2015.

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

CFR	31 March 2015 Actual £m	31 March 2016 Actual £m
Opening balance	41.870	40.211
Add unfinanced capital expenditure	0	0
Less MRP	(1,659)	(703)
Less VRP	0	0
Closing balance	40,211	39,508

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 (2015/16) plus the estimates of any additional capital financing requirement for the current (2016/17) 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 2015/16.

	31 March 2015 Actual £m	31 March 2016 Actual £m
External Debt	40.751	39.700
Investments	65.425	54.119
Net Borrowing Position	(24.674)	(14.419)
CFR	40.211	39.508

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 2013/14 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.

	2014/15	2015/16
Authorised limit	£49m	£48m
Operational boundary	£45m	£44m
Maximum gross borrowing position	£42m	£41m
Financing costs as a proportion of net revenue stream	3.63%	2.84%

5. Overall Treasury Position as at 31 March 2016

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 2015/16 the Authority's position was as follows:

	31 March 2015 Principal	Rate/ Return	31 March 2016 Principal	Rate/ Return
Fixed Rate Loans:				
PWLB	***£36.9***	***5.7%***	***£36.1***	***5.6%***
Ex WMCC	***£3.8***	***6.6%***	***£3.6***	***6.9%***
Total Debt	***£40.7***	***5.8%***	***£39.7***	***5.7%***
CFR	***£40.2***		***£39.5***	
Over / (under) borrowing	***£0.5***		***£0.2***	
Investments:				
Sandwell MBC	***£65.4***	***0.4%***	***£54.1***	***0.5%***
Net Debt	**(£24.7)**		**(£14.4)**	

The maturity structure of the debt portfolio was as follows:

	31 March 2015 Actual £m	31 March 2016 Actual £m
Under 12 months	1.052	1.073
12 months and within 24 months	1.073	1,264
24 months and within 5 years	2.930	3,688
5 years and within 10 years	6.348	5,414
10 years and above	29.348	28,261

6. The Strategy for 2015/16

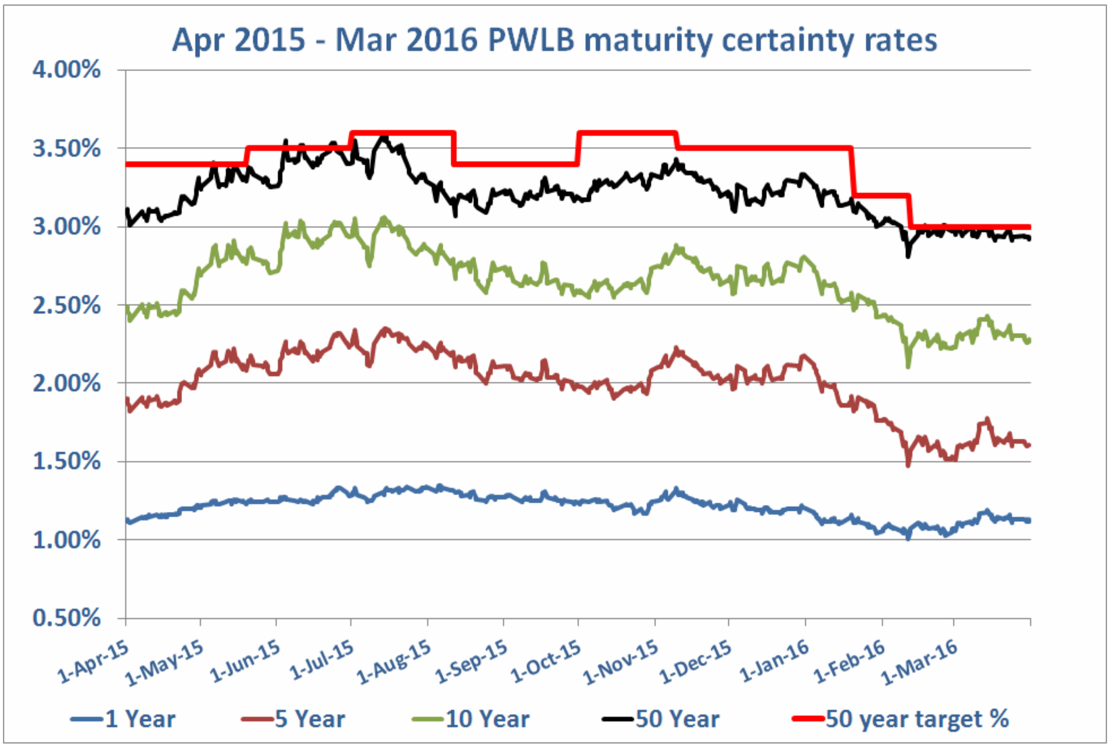
The expectation for interest rates within the treasury management strategy for 2015/16 anticipated low but rising Bank Rate, (starting in quarter 1 of 2016), and gradual rises in medium and longer term fixed borrowing rates during 2016/17. Variable, or short-term rates, were expected to be the cheaper 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 low 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 sharp volatility in equity markets during the year was reflected in sharp volatility in bond yields. However, the overall dominant trend in bond yields since July 2015 has been for yields to fall to historically low levels as forecasts for inflation have repeatedly been revised downwards and expectations of increases in central rates have been pushed back.

7. Borrowing Rates in 2015/16

PWLB borrowing rates - the graph below shows how PWLB certainty rates have risen from historically very low levels during the year.



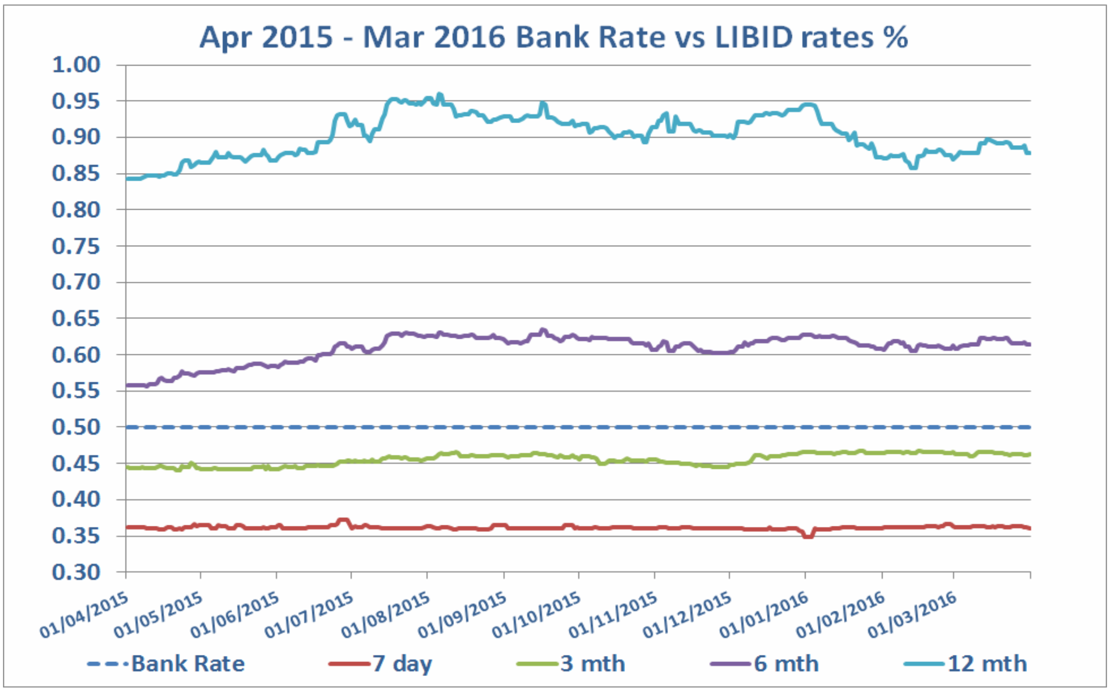
8. Borrowing Outturn for 2015/16

Borrowing – No borrowing was undertaken during 2015/16.

Rescheduling – No rescheduling was undertaken during 2015/16.

9. Investment Rates in 2015/16

Bank Rate remained at its historic low of 0.5% throughout the year; it has now remained unchanged for seven years. Market expectations as to the timing of the start of monetary tightening started the year at quarter 1 2016 but then moved back to around quarter 2 2018 by the end of the year. Deposit rates remained depressed during the whole of the year, primarily due to the effects of the Funding for Lending Scheme and due to the continuing weak expectations as to when Bank Rate would start rising.



10. Investment Outturn for 2015/16

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 16th February 2015. 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 £66.3m of internally managed funds. The internally managed funds earned an average rate of return of 0.46%. The comparable performance indicator is the average 7-day LIBID rate, which was 0.36%. This compares with a budget assumption of £61m investment balances earning an average rate of 0.40%.