WEST MIDLANDS FIRE AND RESCUE AUTHORITY

AUDIT AND RISK COMMITTEE

19 JULY 2021

1. TREASURY MANAGEMENT – ANNUAL REPORT 2020/2021

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 2020/2021 Treasury Management Strategy Statement and Annual Investment Strategy and its Prudential Indicators in February 2020. 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 2020/2021 and the actual Prudential Indicators for 2020/2021.

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 2020/2021.

3.2 Appendix A, the Annual Treasury Management Report 2020/2021 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 2020
Treasury Management Mid-Year Report – Audit and Risk Committee October 2020
Link Treasury Services – Treasury Management Bulletins and Newsletters

The contact officer for this report is Assistant Chief Fire Officer, Gary Taylor, telephone number 0121 380 6006.

MIKE GRIFFITHS
TREASURER

APPENDIX A

WEST MIDLANDS FIRE SERVICE

Annual Treasury Management Review 2020/21

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 2020/21. 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 2020/21 the minimum reporting requirements were that the Authority should receive the following reports:

- an annual treasury strategy in advance of the year (Authority 17/02/2020)
- a mid-year treasury update report (Audit Committee 26/10/2020)
- 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 2020/21 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	2019/20	2020/21
Actual capital expenditure	£5.283m	£2.304m
Total Capital Financing Requirement	£36.259m	£35.322m
Financing costs to net revenue stream	2.5%	2.6%

The Treasurer confirms that no borrowing was undertaken for any capital purpose during 2020/21 and that the statutory borrowing limit (the authorised limit), was not breached.

As at 31st March 2021, the Authority's external debt was £33.676m (£35.697m as at 31st March 2020) and its investment totalled £36.742m (£45.583m as at 31st March 2020).

2. The Economy and Interest Rates

UK. Coronavirus. The financial year 2020/21 will go down in history as being the year of the pandemic. The first national lockdown in late March 2020 did huge damage to an economy that was unprepared for such an eventuality. This caused an economic downturn that exceeded the one caused by the financial crisis of 2008/09. A short second lockdown in November did relatively little damage but by the time of the third lockdown in January 2021, businesses and individuals had become more resilient in adapting to working in new ways during a three month lockdown so much less damage than was caused than in the first one. The advent of vaccines starting in November 2020, were a game changer. The way in which the UK and US have led the world in implementing a fast programme of vaccination which promises to lead to a return to something approaching normal life during the second half of 2021, has been instrumental in speeding economic recovery and the reopening of the economy. In addition, the household saving rate has been exceptionally high since the first lockdown in March 2020 and so there is plenty of pent-up demand and purchasing power stored up for services in the still-depressed sectors like restaurants, travel and hotels as soon as they reopen. It is therefore expected that the UK economy could recover its pre-pandemic level of economic activity during quarter 1 of 2022.

The Monetary Policy Committee cut Bank Rate from 0.75% to 0.25% and then to 0.10% in March 2020 and embarked on a £200bn programme of quantitative easing QE (purchase of gilts so as to reduce borrowing costs throughout the economy by lowering gilt yields). The MPC increased then QE by £100bn in June and by £150bn in November to a total of £895bn. While Bank Rate remained unchanged for the rest of the year, financial markets were concerned that the MPC could cut Bank Rate to a negative rate; this was firmly discounted at the February 2021 MPC meeting when it was established that commercial banks would be unable to implement negative rates for at least six months – by which time the economy was expected to be making a strong recovery and negative rates would no longer be needed.

Average inflation targeting. This was the major change adopted by the Bank of England in terms of implementing its inflation target of 2%. The key addition to the Bank's forward guidance in August was a new phrase in the policy statement, namely that "it does not intend to tighten monetary policy until there is clear evidence that significant progress is being made in eliminating spare capacity and achieving the 2% target sustainably". That seems designed to say, in effect, that even if inflation rises to 2% in a couple of years' time, do not expect any action from the MPC to raise Bank Rate – until they can clearly see that level of inflation is going to be persistently above target if it takes no action to raise Bank Rate. This sets a high bar for raising Bank Rate and no increase is expected by March 2024, and possibly for as long as five years. Inflation has been well under 2% during 2020/21; it is expected to briefly peak at just over 2% towards the end of 2021, but this is a temporary short lived factor and so not a concern to the MPC.

Government support. The Chancellor has implemented repeated rounds of support to businesses by way of cheap loans, other measures and by protected jobs by paying for workers to be placed on furlough. This support has come at a cost in terms of the Government's budget deficit ballooning in 2020/21 and 2021/22 so that the Debt to GDP ratio reaches around 100%. The Budget on 3rd March 2021 increased fiscal support to the economy and employment during 2021 and 2022 followed by tax rises in the following three years to help to pay the cost for the pandemic. This will help further to strengthen the economic recovery from the pandemic and to return the government's finances to a balanced budget on a current expenditure and income basis in 2025/26. This will stop the Debt to GDP ratio rising further from 100%.

BREXIT. The final agreement on 24th December 2020 eliminated a significant downside risk for the UK economy. The initial agreement only covered trade so there is further work to be done on the services sector where temporary equivalence has been granted in both directions between the UK and EU; that now needs to be formalised on a permanent basis. There was disruption to trade in January as form filling has proved to be a formidable barrier to trade. This appears to have eased somewhat since then but is an area that needs further work to ease difficulties, which are still acute in some areas.

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.

	2019/20 Actual £m	2020/21 Actual £m
Total capital expenditure	**5.283**	**2.304**
Resourced by:		
• Capital receipts	0.000	0.000
• Capital grants	0.083	0.000
• Revenue Contribution to Capital	5.200	2.304
Capital Expenditure Financed from Borrowing	**0**	**0**

4. Overall Treasury Position as at 31 March 2021

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 2020/21 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 2020/21 was approved 17 February 2020.

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

CFR	31 March 2020 Actual £m	31 March 2021 Actual £m
Opening balance	37.143	36.259
Add unfinanced capital expenditure	0	0
Less MRP	(0.884)	(0.937)
Less VRP	0	0
Closing balance	36.259	35.322

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 (2020/21) plus the estimates of any additional capital financing requirement for the current (2021/22) 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 2020/21.

	31 March 2020 Actual £m	31 March 2021 Actual £m
External Debt	35.697	33.676
Investments	45.583	36.742
Net Borrowing Position	(9.886)	(3.066)
CFR	36.259	35.322

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 2020/21 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.

	2019/20	2020/21
Authorised limit	£44m	£43m
Operational boundary	£40m	£39m
Maximum gross borrowing position	£37m	£36m
Financing costs as a proportion of net revenue stream	2.5%	2.6%

5. Overall Treasury Position as at 31 March 2021

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 2020/21, the Authority's position was as follows:

	31 March 2020 Principal £m	Rate/ Return	31 March 2021 Principal £m	Rate/ Return
Fixed Rate Loans:				
PWLB	*£33.1*	*5.3%*	*£31.4*	*5.2%*
Ex WMCC	*£2.6*	*5.6%*	*£2.3*	*5.6%*
Total Debt	*£35.7*	*5.4%*	*£33.7*	*5.3%*
CFR	*£36.3*		*£35.3*	
Over / (under) borrowing	*(£0.6)*		*(£1.6)*	
Investments:				
Sandwell MBC	*£45.6*	*0.9%*	*£36.7*	*0.24%*
Net Debt	(£9.9)		(£1.4)	

The maturity structure of the debt portfolio was as follows:

	31 March 2020 Actual £m	31 March 2021 Actual £m
Under 12 months	1.992	2.141
12 months and within 24 months	2.476	0.827
24 months and within 5 years	1.685	2.447
5 years and within 10 years	2.834	1.561
10 years and above	26.700	26.700

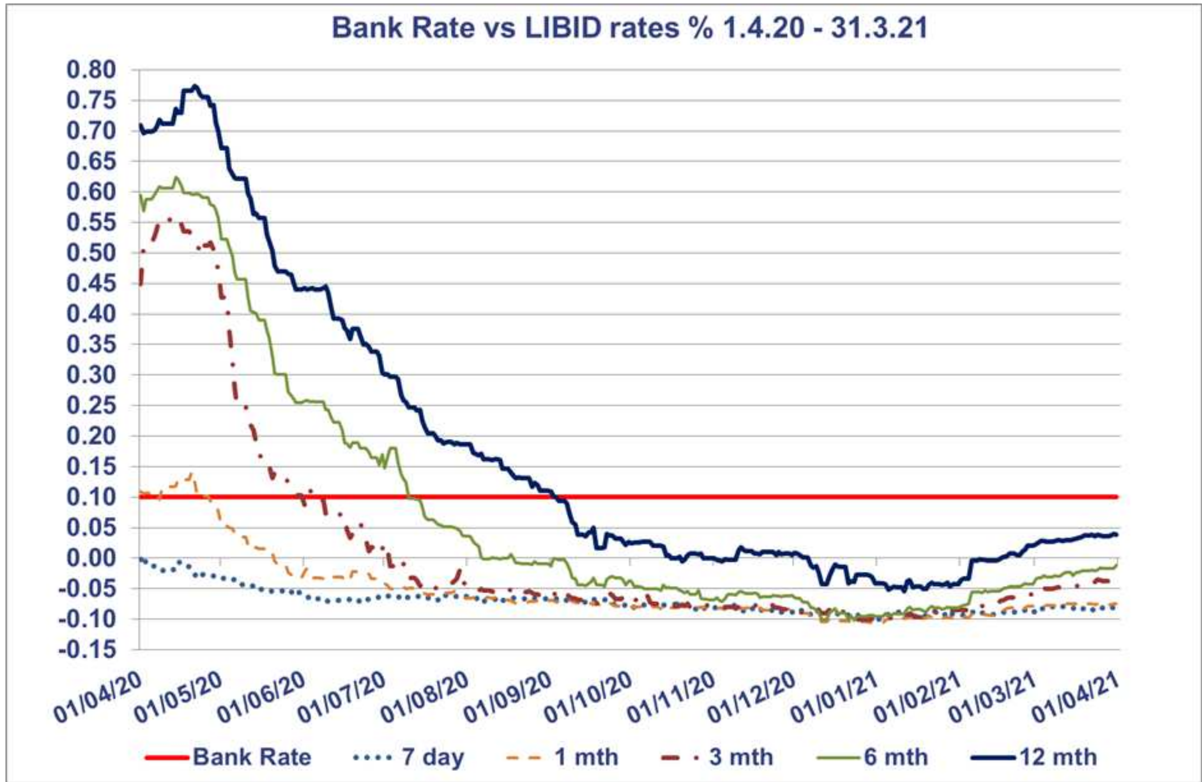
6. The Strategy for 2020/21

Investment returns which had been low during 2019/20, plunged during 2020/21 to near zero or even into negative territory. Most local authority lending managed to avoid negative rates and one feature of the year was the growth of inter local authority lending. The expectation for interest rates within the treasury management strategy for 2020/21 was that Bank Rate would continue at the start of the year at 0.75 % before rising to end 2022/23 at 1.25%. This forecast was invalidated by the Covid-19 pandemic in March 2020 which caused the Monetary Policy Committee to cut Bank Rate in March, first to 0.25% and then to 0.10%, in order to counter the hugely negative impact of the national lockdown on the economy. The Bank of England and the Government also introduced new programmes of supplying the banking system and the economy with considerable amounts of cheap credit so that banks could help cash-starved businesses to survive the lockdown. The Government also supplied large amounts of finance to local authorities to pass on to businesses. This meant that for most of the year there was much more liquidity in financial markets than there was demand to borrow, with the consequent effect that investment earnings rates plummeted.

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 as illustrated in the charts shown above and below. Such an approach has also provided benefits in terms of reducing the counterparty risk exposure, by having fewer investments placed in the financial markets.

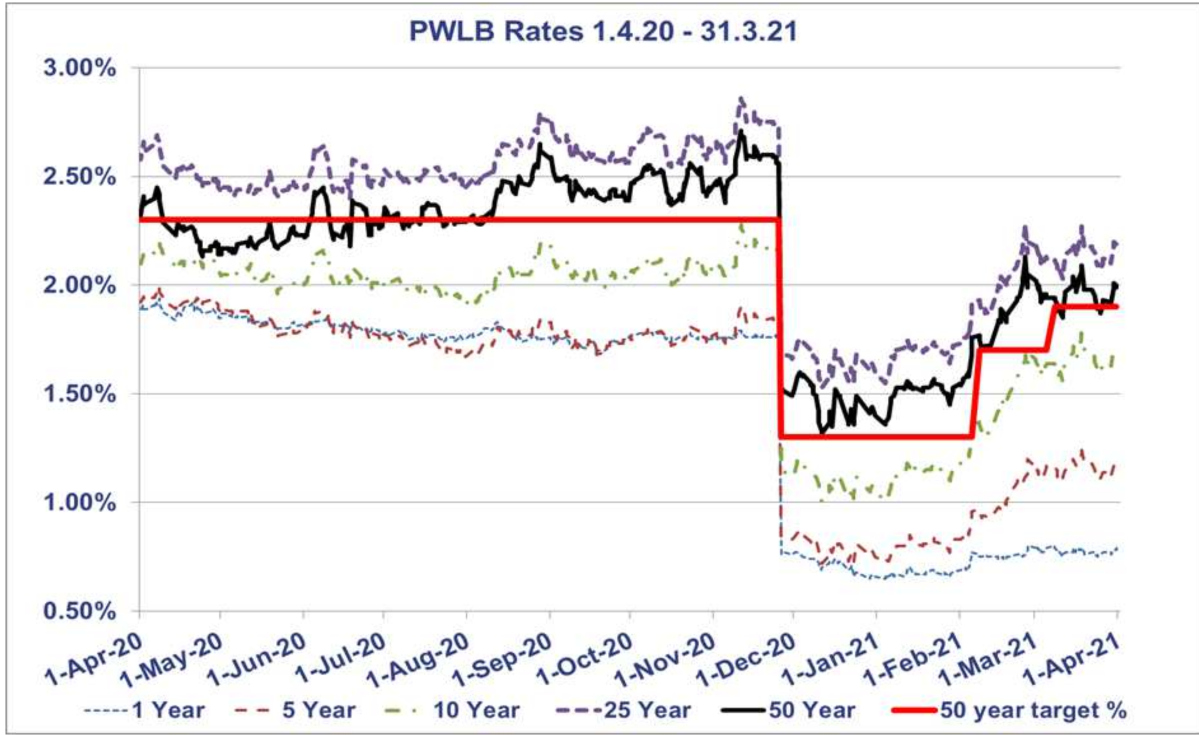
Investment strategy and control of interest rate risk



	Bank Rate	7 day	1 mth	3 mth	6 mth	12 mth
High	0.10	0.00	0.14	0.56	0.62	0.77
High Date	01/04/2020	02/04/2020	20/04/2020	08/04/2020	14/04/2020	21/04/2020
Low	0.10	-0.10	-0.11	-0.10	-0.10	-0.05
Low Date	01/04/2020	31/12/2020	29/12/2020	23/12/2020	21/12/2020	11/01/2021
Average	0.10	-0.07	-0.05	0.01	0.07	0.17
Spread	0.00	0.10	0.25	0.66	0.73	0.83

7. **Borrowing Rates in 2020/21**

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 2020/**21

Borrowing – No borrowing was undertaken during 2020/21.

Rescheduling – No rescheduling was undertaken during 2020/21.

9. **Investment Outturn for 2020/21**

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 17 February 2020. 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 £49.6m of internally managed funds. The internally managed funds earned an average rate of return of 0.24%. The comparable performance indicator is the average 3 month LIBID rate, which was 0.02%. This compares with a budget assumption of £50m investment balances earning an average rate of 0.20%.