APPENDIX A

WEST MIDLANDS FIRE SERVICE

Annual Treasury Management Review
2017/18

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 2017/18. 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 2017/18 the minimum reporting requirements were that the Authority should receive the following reports:

- an annual treasury strategy in advance of the year (Authority 20/02/2017)
- a mid-year treasury update report (Audit Committee 13/11/2017)
- 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 2017/18 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	2016/17	2017/18
Actual capital expenditure	£3.677m	£4.527m
Total Capital Financing Requirement	£38.764m	£37.977m
Financing costs to net revenue stream	2.7%	2.7%

The Treasurer confirms that no borrowing was undertaken for any capital purpose during 2017/18 and that the statutory borrowing limit (the authorised limit), was not breached.

As at 31st March 2018, the Authority's external debt was £37.363m (£38.627m as at 31st March 2017) and its investment totalled £51.905m (£58.022m as at 31st March 2017).

2. The Economy and Interest Rates

During the calendar year of 2017, there was a major shift in expectations in financial markets in terms of how soon Bank Rate would start on a rising trend. After the UK economy surprised on the upside with strong growth in the second half of 2016, growth in 2017 was disappointingly weak in the first half of the year which meant that growth was the slowest for the first half of any year since 2012. The main reason for this was the sharp increase in inflation caused by the devaluation of sterling after the EU referendum, feeding increases into the cost of imports into the economy. This caused a reduction in consumer disposable income and spending power as inflation exceeded average wage increases. Consequently, the services sector of the economy, accounting for around 75% of GDP, saw weak growth as consumers responded by cutting back on their expenditure. However, growth did pick up modestly in the second half of 2017. Consequently, market expectations during the autumn, rose significantly that the MPC would be heading in the direction of imminently raising Bank Rate. The minutes of the MPC meeting of 14th September indicated that the MPC was likely to raise Bank Rate very soon. The 2nd November MPC quarterly Inflation Report meeting duly delivered by raising Bank Rate from 0.25% to 0.50%.

The 8th February MPC meeting minutes then revealed another sharp hardening in MPC warnings on a more imminent and faster pace of increases in Bank Rate than had previously been expected.

Market expectations for increases in Bank Rate, therefore, shifted considerably during the second half of 2017/18 and resulted in investment rates from 3 – 12 months increasing sharply during the spring quarter.

PWLB borrowing rates increased correspondingly to the above developments with the shorter term rates increasing more sharply than longer term rates. In addition, UK gilts have moved in a relatively narrow band this year, (within 25 bps for much of the year), compared to US treasuries. During the second half of the year, there was a noticeable trend in treasury yields being on a rising trend with the Fed raising rates by 0.25% in June, December and March, making six increases in all from the floor. The effect of these three increases was greater in shorter terms around 5 year, rather than longer term yields.

The major UK landmark event of the year was the inconclusive result of the general election on 8 June 2017. However, this had relatively little impact on financial markets.

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.

	2016/17 Actual £m	2017/18 Actual £m
Total capital expenditure	**3.677**	**4.527**
Resourced by:		
• Capital receipts	1.122	0.000
• Capital grants	2.388	0.173
• Revenue Contribution to Capital	0.167	4.354
Capital Expenditure Financed from Borrowing	**0**	**0**

4. Overall Treasury Position as at 31 March 2018

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 2017/18 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 2017/18 was approved 20th February 2017.

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

CFR	31 March 2017 Actual £m	31 March 2018 Actual £m
Opening balance	39.508	38.764
Add unfinanced capital expenditure	0	0
Less MRP	(0.744)	(0.787)
Less VRP	0	0
Closing balance	38.764	37.977

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 (2017/18) plus the estimates of any additional capital financing requirement for the current (2017/18) 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 2017/18.

	31 March 2017 Actual £m	31 March 2018 Actual £m
External Debt	38.627	37.363
Investments	58.022	51.905
Net Borrowing Position	(19.395)	(14.542)
CFR	38.764	37.977

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 2017/18 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.

	2016/17	2017/18
Authorised limit	£47m	£46m
Operational boundary	£43m	£42m
Maximum gross borrowing position	£40m	£39m
Financing costs as a proportion of net revenue stream	2.7%	2.7%

5. Overall Treasury Position as at 31 March 2018

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 2017/18 the Authority's position was as follows:

	31 March 2017 Principal £m	Rate/ Return	31 March 2018 Principal £m	Rate/ Return
Fixed Rate Loans:				
PWLB	*£35.2*	*5.5%*	*£34.2*	*5.4%*
Ex WMCC	*£3.4*	*6.8%*	*£3.2*	*6.1%*
Total Debt	*£38.6*	*5.6%*	*£37.4*	*5.5%*
CFR	*£38.8*		*£38.0*	
Over / (under) borrowing	*(£0.2)*		*(£0.6)*	
Investments:				
Sandwell MBC	*£58.0*	*0.4%*	*£51.9*	*0.4%*
Net Debt	(£19.4)		(£14.5)	

The maturity structure of the debt portfolio was as follows:

	31 March 2017 Actual £m	31 March 2018 Actual £m
Under 12 months	1.264	1,361
12 months and within 24 months	1.361	305
24 months and within 5 years	4.467	4,990
5 years and within 10 years	4.033	4,007
10 years and above	27.502	26,700

6. The Strategy for 2017/18

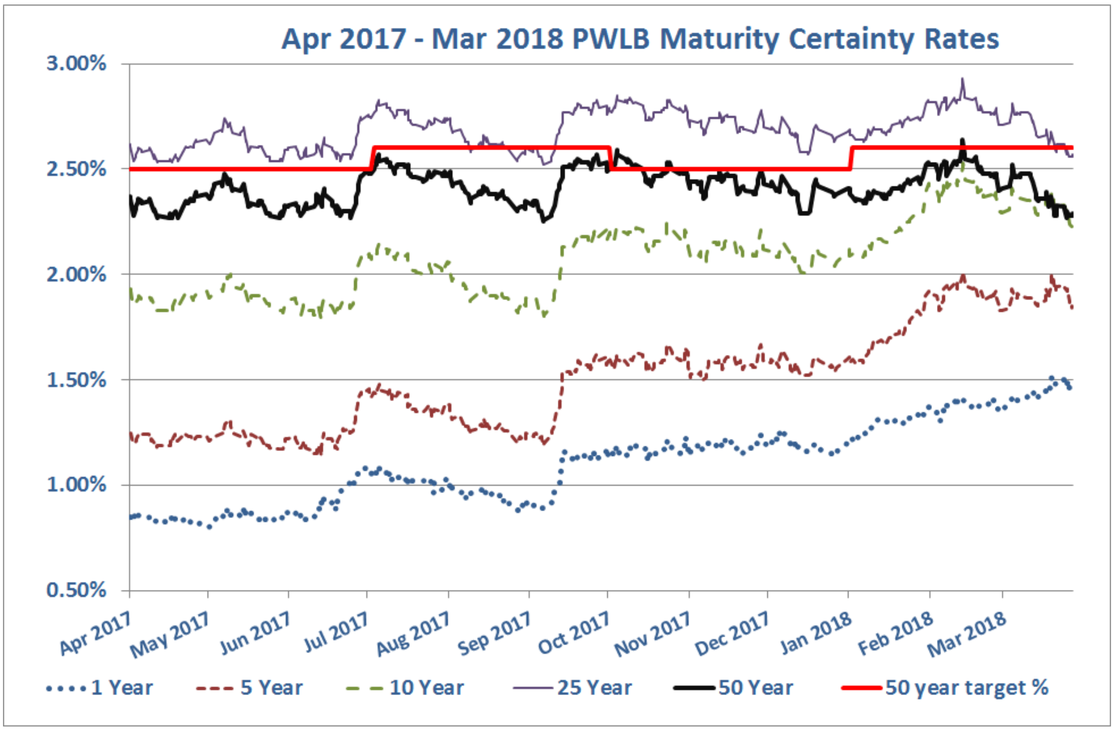
The expectation for interest rates within the treasury management strategy for 2017/18 anticipated that Bank Rate would not start rising from 0.25% until quarter 2 2019 and then only increase once more before 31.3.20. There would also be gradual rises in medium and longer term fixed borrowing rates during 2017/18 and the two subsequent financial years. 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.

During 2017/18, longer term PWLB rates were volatile but with little overall direction, whereas shorter term PWLB rates were on a rising trend during the second half of the year.

7. Borrowing Rates in 2017/18

The graphs and tables 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.



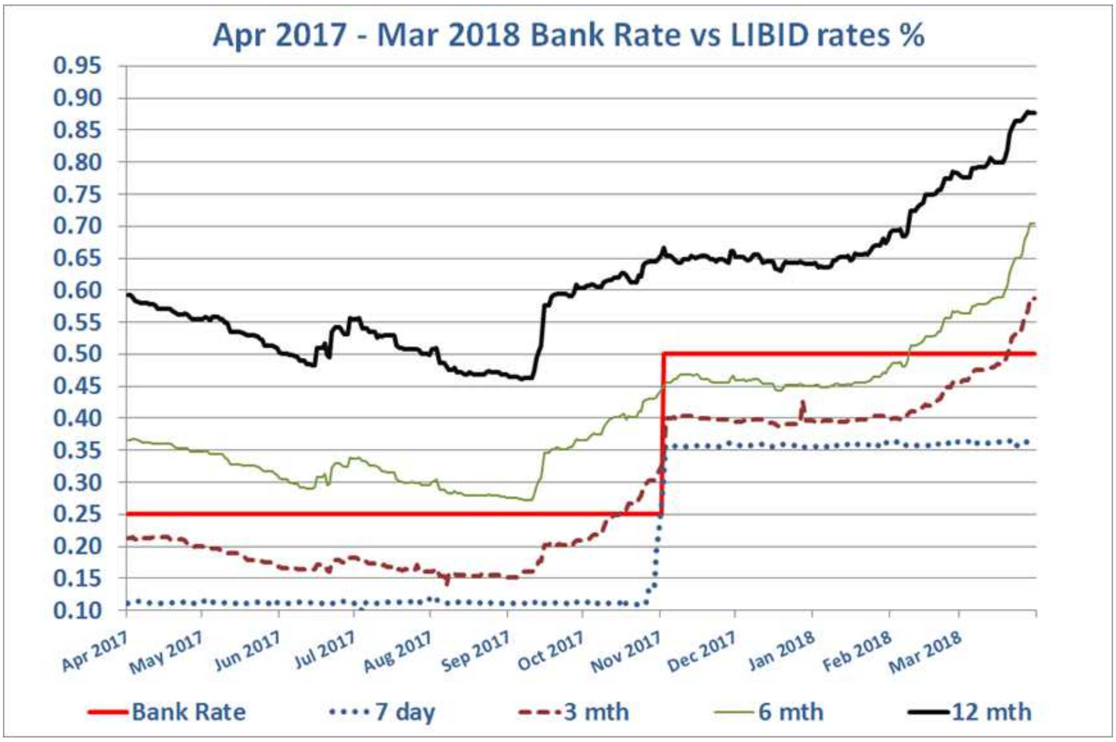
8. Borrowing Outturn for 2017/18

Borrowing – No borrowing was undertaken during 2017/18.

Rescheduling – No rescheduling was undertaken during 2017/18.

9. Investment Rates in 2017/18

Investments rates for 3 months and longer have been on a rising trend during the second half of the year in the expectation of Bank Rate increasing from its floor of 0.25%, and reached a peak at the end of March. Bank Rate was duly raised from 0.25% to 0.50% on 2/11/17 and remained at that level for the rest of the year. However, further increases are expected over the next few years. Deposit rates continued into the start of 2017/18 at previous depressed levels due, in part, to a large tranche of cheap financing being made available under the Term Funding Scheme to the banking sector by the Bank of England; this facility ended on 28/2/18.



10. Investment Outturn for 2017/18

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 20th February 2017. 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 £62.2m of internally managed funds. The internally managed funds earned an average rate of return of 0.404%. The comparable performance indicator is the average 7-day LIBID rate, which was 0.21%. This compares with a budget assumption of £70m investment balances earning an average rate of 0.35%.

11. Other Issues

Revised CIPFA Codes
In December 2017, the Chartered Institute of Public Finance and Accountancy, (CIPFA), issued a revised Treasury Management Code and Cross Sectoral Guidance Notes, and a revised Prudential Code.
A particular focus of these revised codes was how to deal with local authority investments which are not treasury type investments e.g. by investing in purchasing property in order to generate income for the Authority at a much higher level than can be attained by treasury investments. One recommendation was that local authorities should produce a new report to members to give a high level summary of the overall capital strategy and to enable members to see how the cash resources of the Authority have been apportioned between treasury and non-treasury investments.

Markets in Financial Instruments Directive II (MiFID II)
The EU set the date of 3rd January 2018 for the introduction of regulations under MIFID II. These regulations govern the relationship that financial institutions conducting lending and borrowing transactions will have with local authorities from that date. This has had little effect on this Authority apart from having to fill in forms sent by each institution dealing with this Authority and for each type of investment instrument we use, apart from for cash deposits with banks and building societies.