WEST MIDLANDS FIRE AND RESCUE AUTHORITY

AUDIT AND RISK COMMITTEE

18 JULY 2022

1. **TREASURY MANAGEMENT – ANNUAL REPORT 2021/2022**

Report of the Treasurer.

RECOMMENDED

1.1 THAT the report and Appendix are noted and the prudential and treasury indicators approved.

2. **PURPOSE OF REPORT**

2.1 The Authority agreed its 2021/2022 Treasury Management Strategy Statement and Annual Investment Strategy and its Prudential Indicators in February 2021. 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 2021/2022 and the actual Prudential Indicators for 2021/2022.

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 2021/2022.

3.2 Appendix A, the Annual Treasury Management Report 2021/2022 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

4.1 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

5.1 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

6.1 These are contained in the body of the report and the attached Appendix.

7. ENVIRONMENTAL IMPLICATIONS

7.1 There are no environmental implications arising from this report.

BACKGROUND PAPERS

Authority's Budget and Precept Report – February 2021
Treasury Management Mid-Year Report – Audit and Risk Committee December 2021
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
2021/22

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 2021/22. 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 2021/22 the minimum reporting requirements were that the Authority should receive the following reports:

- an annual treasury strategy in advance of the year (Authority 15/02/2021)
- a mid-year treasury update report (Audit & Risk Committee 06/12/2021)
- 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 2021/22 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	2020/21	2021/22
Actual capital expenditure	£2.304m	£3.189m
Total Capital Financing Requirement	£35.322m	£34.327m
Financing costs to net revenue stream	2.6%	2.5%

The Treasurer confirms that no borrowing was undertaken for any capital purpose during 2021/22 and that the statutory borrowing limit (the authorised limit), was not breached.

As at 31st March 2022, the Authority's external debt was £31.534m (£33.676m as at 31st March 2021) and its investment totalled £33.455m (£36.742m as at 31st March 2021).

2. The Economy and Interest Rates

UK Economy - Over the last two years, the coronavirus outbreak has done huge economic damage to the UK and to economies around the world. After the Bank of England took emergency action in March 2020 to cut Bank Rate to 0.10%, it left Bank Rate unchanged at its subsequent meetings until raising it to 0.25% at its meeting on 16th December 2021, 0.50% at its meeting of 4th February 2022 and then to 0.75% in March 2022.

The UK economy has endured several false dawns through 2021/22, but with most of the economy now opened up and nearly back to business-as-usual, the GDP numbers have been robust (9% y/y Q1 2022) and sufficient for the MPC to focus on tackling the second-round effects of inflation, now that the CPI measure has already risen to 6.2% and is likely to exceed 8% in April.

Gilt yields fell towards the back end of 2021, but despite the war in Ukraine gilt yields have shot higher in early 2022. At 1.38%, 2-year yields remain close to their recent 11-year high and 10-year yields of 1.65% are close to their recent six-year high. These rises have been part of a global trend as central banks have suggested they will continue to raise interest rates to contain inflation.

Historically, a further rise in US Treasury yields will probably drag UK gilt yields higher. There is a strong correlation between the two factors. However, the squeeze on real household disposable incomes arising from the 54% leap in April utilities prices as well as rises in council tax, water prices and many phone contract prices, are strong headwinds for any economy to deal with. In addition, from 1st April 2022, employees also pay 1.25% more in National Insurance tax. Consequently, inflation will be a bigger drag on real incomes in 2022 than in any year since records began in 1955.

Average inflation targeting - This was the major change in 2020/21 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 2020 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 mantra now seems very dated. Inflation is the "genie" that has escaped the bottle, and a perfect storm of supply side shortages, labour shortages, commodity price inflation, the impact of Russia's invasion of Ukraine and subsequent Western sanctions all point to inflation being at elevated levels until well into 2023.

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.

	2020/21 Actual £m	2021/22 Actual £m
Total capital expenditure	**2.304**	**3.189**
Resourced by:		
• Capital receipts	0.000	0.000
• Capital grants	0.000	0.000
• Revenue Contribution to Capital	2.304	3.189
Capital Expenditure Financed from Borrowing	**0**	**0**

4. Overall Treasury Position as at 31 March 2022

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 2021/22 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 2021/22 was approved 15 February 2021.

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

CFR	31 March 2021 Actual £m	31 March 2022 Actual £m
Opening balance	36.259	35.322
Add unfinanced capital expenditure	0	0
Less MRP	(0.937)	(0.995)
Less VRP	0	0
Closing balance	35.322	34.327

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 (2021/22) plus the estimates of any additional capital financing requirement for the current (2022/23) 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 2021/22.

	31 March 2021 Actual £m	31 March 2022 Actual £m
External Debt	33.676	31.534
Investments	36.742	33.455
Net Borrowing Position	(3.066)	(1.921)
CFR	35.322	34.327

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.

	2020/21	2021/22
Authorised limit	£43m	£42m
Operational boundary	£39m	£38m
Maximum gross borrowing position	£36m	£34m
Financing costs as a proportion of net revenue stream	2.6%	2.5%

5. Overall Treasury Position as at 31 March 2022

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 2021/22, the Authority's position was as follows:

	31 March 2021 Principal £m	Rate/ Return	31 March 2022 Principal £m	Rate/ Return
Fixed Rate Loans:				
PWLB	*£31.4*	*5.2%*	*£29.6*	*5.22%*
Ex WMCC	*£2.3*	*5.6%*	*£1.9*	*5.51%*
Total Debt	*£33.7*	*5.3%*	*£31.5*	*5.24%*
CFR	*£35.3*		*£34.3*	
Over / (under) borrowing	*(£1.6)*		*(£2.8)*	
Investments:				
Sandwell MBC	*£36.7*	*0.24%*	*£33.5*	*0.16%*
Net Debt	(£3.0)		(£2.0)	

The maturity structure of the debt portfolio was as follows:

	31 March 2021 Actual £m	31 March 2022 Actual £m
Under 12 months	2.141	0.827
12 months and within 24 months	0.827	0.867
24 months and within 5 years	2.447	2.338
5 years and within 10 years	1.561	0.802
10 years and above	26.700	26.700

6. The Strategy for 2021/22

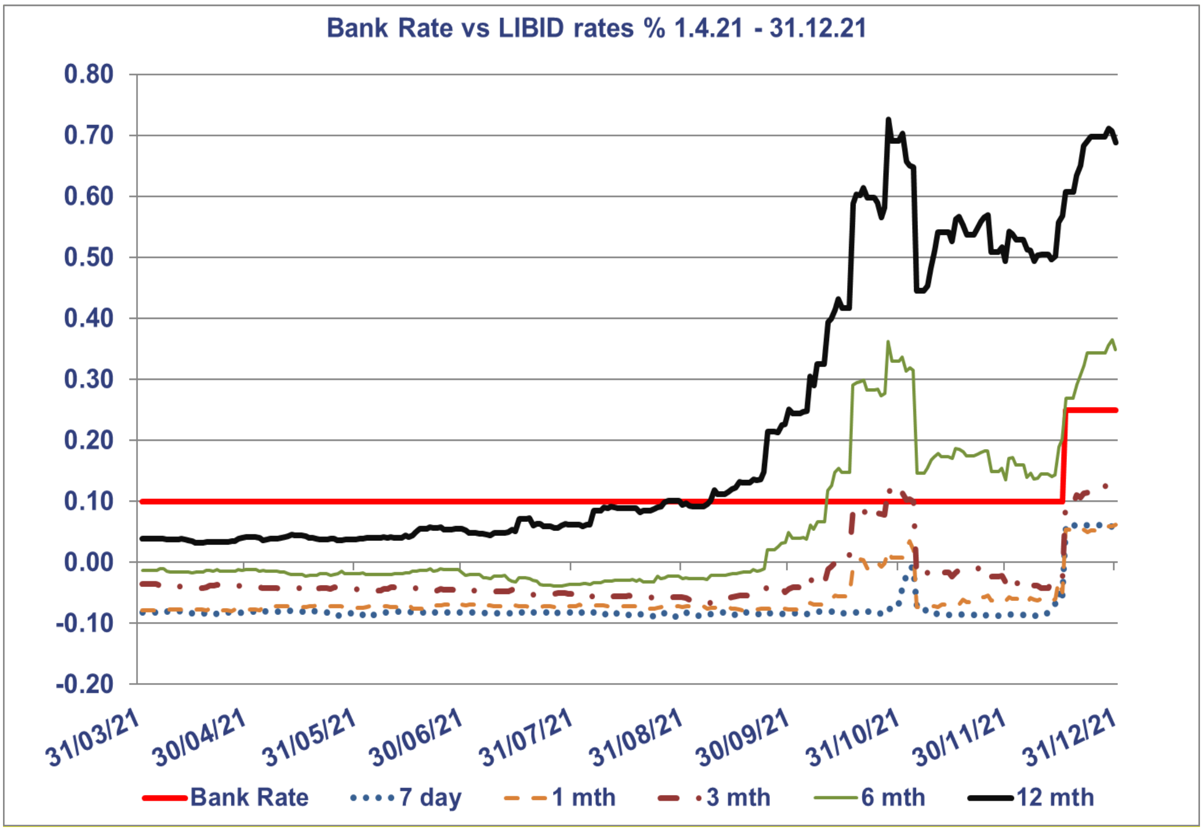
Investment returns remained close to zero for much of 2021/22. Most local authority lending managed to avoid negative rates. The expectation for interest rates within the treasury management strategy for 2021/22 was that Bank Rate would remain at 0.1% until it was clear to the Bank of England that the emergency level of rates introduced at the start of the Covid-19 pandemic were no longer necessitated.

The Bank of England and the Government also maintained various monetary and fiscal measures, supplying the banking system and the economy with massive amounts of cheap credit so that banks could help cash-starved businesses to survive the various lockdowns/negative impact on their cashflow. The Government also supplied huge 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 remained low until towards the turn of the year when inflation concerns indicated central banks, not just the Bank of England, would need to lift interest rates to combat the second-round effects of growing levels of inflation (CPI was 6.2% in February).

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 counterparty risk exposure, by having fewer investments placed in the financial markets.

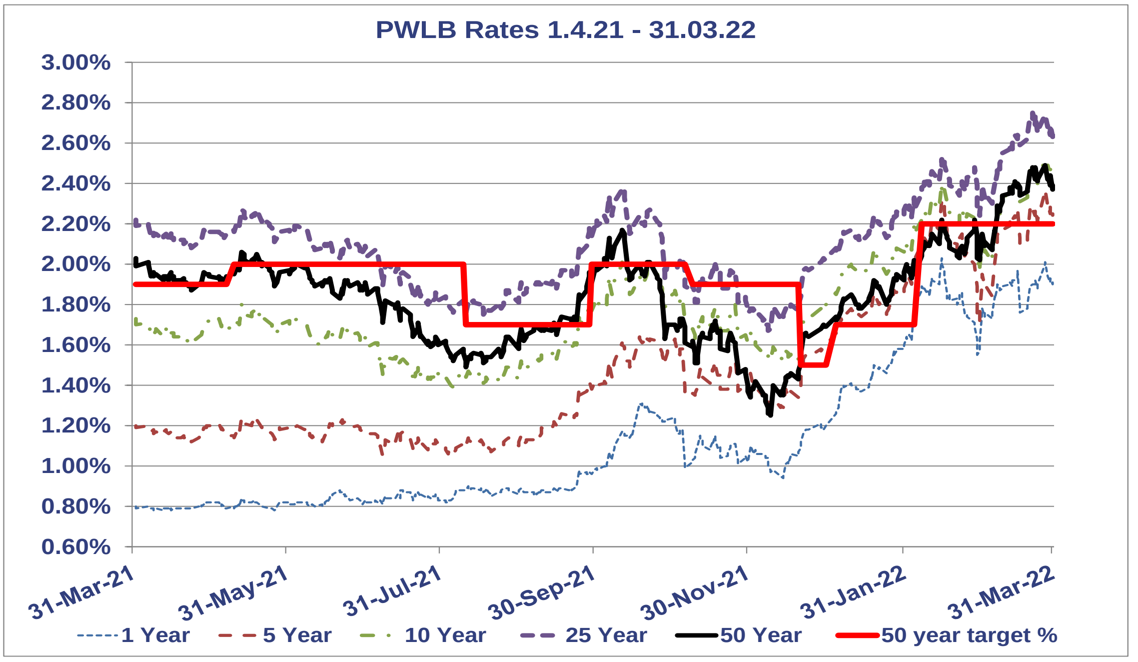
Investment strategy and control of interest rate risk



	Bank Rate	7 day	1 mth	3 mth	6 mth	12 mth
High	0.25	0.06	0.06	0.14	0.36	0.73
High Date	17/12/2021	29/12/2021	31/12/2021	31/12/2021	30/12/2021	28/10/2021
Low	0.10	-0.09	-0.08	-0.07	-0.04	0.04
Low Date	01/07/2021	27/08/2021	17/09/2021	08/09/2021	27/07/2021	08/07/2021
Average	0.11	-0.07	-0.05	-0.01	0.09	0.31
Spread	0.15	0.15	0.14	0.20	0.40	0.68

7. **Borrowing Rates in 2021/22**

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 2021/22**

Borrowing – No borrowing was undertaken during 2021/22.

Rescheduling – No rescheduling was undertaken during 2021/22.

9. Investment Outturn for 2021/22

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 15 February 2021. 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 £46.3m of internally managed funds. The internally managed funds earned an average rate of return of 0.164%. This compares with a budget assumption of £45m investment balances earning an average rate of 0.20%.

The comparable performance indicator for internally managed funds is the average 7-day backward looking SONIA (Sterling Overnight Index Average) uncompounded rate as at 31 March 2022, which was 0.1355%. The SONIA replaced the LIBID (London Interbank Bid) rate as a comparable performance indicator in 2021/22.