

WEST MIDLANDS FIRE AND RESCUE AUTHORITY

AUDIT AND RISK COMMITTEE

28 NOVEMBER 2022

1. **TREASURY MANAGEMENT – MID YEAR REVIEW
REPORT 2022/23**

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 Treasury Management Strategy Statement and Annual Investment Strategy and its Prudential Indicators in February 2022. Part of the requirements of the Treasury Strategy and Prudential Code are that periodic reports are presented to Members.

- 2.2 The mid-year review report outlines the performance of the Treasury Management function of the Authority in the current financial year.

3. **BACKGROUND**

- 3.1 The Authority is required to produce a mid-year report of Treasury Management activity in the current financial year.
- 3.2 Appendix 1, the mid-year Review Report 2022/23 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 regulations issued under the Local Government Act 2003.

4. **EQUALITY IMPACT ASSESSMENT**

4.1 In preparing this report an initial Equality Impact Assessment is not 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 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 2022

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

MIKE GRIFFITHS
TREASURER

WEST MIDLANDS FIRE SERVICE



Treasury Management Strategy Statement and Annual Investment Strategy

Mid-year Review Report 2022/23

1. Background

The Authority operates a balanced budget, which broadly means cash raised during the year will meet its cash expenditure. Part of the treasury management operations ensure this cash flow is adequately planned, with surplus monies being invested in low-risk counterparties, providing adequate liquidity initially before considering maximising investment return.

The second main function of the treasury management service is the funding of the Authority's capital plans. These capital plans provide a guide to the borrowing need of the Authority, essentially the longer-term cash flow planning to ensure the Authority can meet its capital spending operations. This management of longer-term cash may involve arranging long or short-term loans, or using longer term cash flow surpluses, and on occasion any debt previously drawn may be restructured to meet Authority risk or cost objectives.

Accordingly, treasury management is defined as:

“The management of the local authority’s investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks.”

2. Introduction

The Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management has been adopted by this Authority.

The primary requirements of the Code are as follows:

- Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Authority's treasury management activities.
- Creation and maintenance of Treasury Management Practices which set out the manner in which the Authority will seek to achieve those policies and objectives.
- Receipt by the Authority of an annual Treasury Management Strategy Statement - including the Annual Investment Strategy and Minimum Revenue Provision Policy - for the year ahead, a Mid-year Review Report and an Annual Report covering activities during the previous year.
- Delegation by the Authority of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.
- Delegation by the Authority of the role of scrutiny of treasury

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management strategy and policies to a specific named body. For this Authority the delegated body is the Audit and Risk Committee.

This mid-year report has been prepared in compliance with CIPFA's Code of Practice on Treasury Management, and covers the following:

- An economic update for the first six months of 2022/23;
- A review of the Treasury Management Strategy Statement and Annual Investment Strategy;
- The Authority's capital expenditure and prudential indicators;
- A review of the Authority's investment portfolio for 2022/23;
- A review of the Authority's borrowing strategy for 2022/23;
- A review of any debt rescheduling undertaken during 2022/23;
- A review of compliance with Treasury and Prudential Limits for 2022/23.

3. Economic update

- The second quarter of 2022/23 saw:
 - GDP revised upwards in Q1 2022/23 to +0.2% q/q from -0.1%, which means the UK economy has avoided recession for the time being;
 - Signs of economic activity losing momentum as production fell due to rising energy prices;
 - CPI inflation ease to 9.9% y/y in August, having been 9.0% in April, but domestic price pressures showing little sign of abating in the near-term;
 - The unemployment rate fall to a 48-year low of 3.6% due to a large shortfall in labour supply;
 - Bank Rate rise by 100bps over the quarter, taking Bank Rate to 2.25% with further rises to come;
 - Gilt yields surge and sterling fall following the fiscal event of the new Prime Minister and Chancellor on 23rd September.
- The UK economy grew by 0.2% q/q in Q1 2022/23, though revisions to historic data left it below pre-pandemic levels.
- There are signs of higher energy prices creating more persistent downward effects in economic activity. Both industrial production (-0.3% m/m) and construction output (-0.8% m/m) fell in July 2022 for a second month in a row. Although some of this was probably due to the heat wave at the time, manufacturing output fell in some of the most energy intensive sectors (e.g., chemicals), pointing to signs of higher

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energy prices weighing on production. With the drag on real activity from high inflation having grown in recent months, GDP is at risk of contracting through the autumn and winter months.

- The fall in the composite PMI (a weighted average of the Manufacturing Output Index and the Services Business Activity Index) from 49.6 in August to a 20-month low preliminary reading of 48.4 in September points to a fall in GDP of around 0.2% q/q in Q3 and consumer confidence is at a record low. Retail sales volumes fell by 1.6% m/m in August, which was the ninth fall in ten months. That left sales volumes in August just 0.5% above their pre-COVID level and 3.3% below their level at the start of the year. There are also signs that households are spending their excess savings in response to high prices. Indeed, cash in households' bank accounts rose by £3.2bn in August, which was below the £3.9bn rise in July and much smaller than the 2019 average monthly rate of £4.6bn.
- The labour market remained exceptionally tight. Data for July and August provided further evidence that the weaker economy is leading to a cooling in labour demand. Labour Force Survey (LFS) employment rose by 40,000 in the three months to July (the smallest rise since February). But a renewed rise in inactivity of 154,000 over the same period meant that the unemployment rate fell from 3.8% in June to a new 48-year low of 3.6%. The single-month data showed that inactivity rose by 354,000 in July itself and there are now 904,000 more inactive people aged 16+ compared to before the pandemic in February 2020. The number of vacancies has started to level off from recent record highs but there have been few signs of a slowing in the upward momentum on wage growth. Indeed, in July, the 3my/y rate of average earnings growth rose from 5.2% in June to 5.5%.
- CPI inflation eased from 10.1% in July to 9.9% in August, though inflation has not peaked yet. The easing in August was mainly due to a decline in fuel prices reducing fuel inflation from 43.7% to 32.1%. And with the oil price now just below \$90pb, expectation is to see fuel prices fall further in the coming months.
- However, utility price inflation is expected to add 0.7% to CPI inflation in October when the Ofgem unit price cap increases to, typically, £2,500 per household (prior to any benefit payments). But, as the government has frozen utility prices at that level for two years, energy price inflation will fall sharply after October and have a big downward influence on CPI inflation.
- Nonetheless, the rise in services CPI inflation from 5.7% y/y in July to a 30-year high of 5.9% y/y in August suggests that domestic price pressures are showing little sign of abating. A lot of that is being driven by the tight labour market and strong wage growth. CPI inflation is expected to peak close to 10.4% in November and, with the supply of workers set to remain unusually low, the tight labour market will keep underlying inflationary pressures strong until early next year.

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- During the first half of the financial year, there has been a change of both Prime Minister and Chancellor. The new team have made a step change in government policy. The government's huge fiscal loosening from its proposed significant tax cuts will add to existing domestic inflationary pressures and will potentially leave a legacy of higher interest rates and public debt. Whilst the government's utility price freeze, which could cost up to £150bn (5.7% of GDP) over 2 years, will reduce peak inflation from 14.5% in January next year to 10.4% in November this year, the long list of tax measures announced at the "fiscal event" adds up to a loosening in fiscal policy relative to the previous government's plans of £44.8bn (1.8% of GDP) by 2026/27. These included the reversal of April's national insurance tax on 6th November, the cut in the basic rate of income tax from 20p to 19p in April 2023, the cancellation of next April's corporation tax rise, the cut to stamp duty and the removal of the 45p tax rate, although the 45p tax rate cut announcement has already been reversed.
- Fears that the government has no fiscal anchor on the back of these announcements has meant that the pound has weakened again, adding further upward pressure to interest rates. Whilst the pound fell to a record low of \$1.035 on the Monday following the government's fiscal event, it has since recovered to around \$1.12. That is due to hopes that the Bank of England will deliver a very big rise in interest rates at the policy meeting on 3rd November and the government will lay out a credible medium-term plan in the near term. This was originally expected as part of the fiscal statement on 23rd November but has subsequently been moved forward to an expected release date in October. Nevertheless, with concerns over a global recession growing, there are downside risks to the pound.
- The MPC has now increased interest rates seven times in as many meetings in 2022 and has raised rates to their highest level since the Global Financial Crisis. Even so, coming after the Fed and ECB raised rates by 75 basis points (bps) in their most recent meetings, the Bank of England's latest 50 basis points hike looks relatively dovish. However, the UK's status as a large importer of commodities, which have jumped in price, means that households in the UK are now facing a much larger squeeze on their real incomes.
- Since the fiscal event on 23rd September, expectation is for the Monetary Policy Committee (MPC) to increase interest rates further and faster, from 2.25% currently to a peak of 5.00% in February 2023. The combination of the government's fiscal loosening, the tight labour market and sticky inflation expectations means we expect the MPC to raise interest rates by 100bps at the policy meetings in November (to 3.25%) and 75 basis points in December (to 4%) followed by further 50 basis point hikes in February and March (to 5.00%). Market expectations for what the MPC will do are volatile. If Bank Rate climbs to these levels the housing market looks very vulnerable, which is one reason why the peak in our forecast is lower than the peak of 5.50% -

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5.75% priced into the financial markets at present.

- Throughout 2022/23, gilt yields have been on an upward trend. They were initially caught up in the global surge in bond yields triggered by the surprisingly strong rise in CPI inflation in the US in May. The rises in two-year gilt yields (to a peak of 2.37% on 21st June) and 10-year yields (to a peak of 2.62%) took them to their highest level since 2008 and 2014 respectively. However, the upward trend was exceptionally sharply at the end of September as investors demanded a higher risk premium and expected faster and higher interest rate rises to offset the government's extraordinary fiscal stimulus plans. The 30-year gilt yield rose from 3.60% to 5.10% following the "fiscal event", which threatened financial stability by forcing pension funds to sell assets into a falling market to meet cash collateral requirements. In response, the Bank did two things. First, it postponed its plans to start selling some of its quantitative easing (QE) gilt holdings until 31st October. Second, it committed to buy up to £65bn of long-term gilts to "restore orderly market conditions" until 14th October. In other words, the Bank is restarting QE, although for financial stability reasons rather than monetary policy reasons.
- Since the Bank's announcement on 28th September, the 30-year gilt yield has fallen back from 5.10% to 3.83%. The 2-year gilt yield dropped from 4.70% to 4.30% and the 10-year yield fell back from 4.55% to 4.09%.
- There is a possibility that the Bank continues with QE at the long-end beyond 14th October or it decides to delay quantitative tightening beyond 31st October, even as it raises interest rates. So far at least, investors seem to have taken the Bank at its word that this is not a change in the direction of monetary policy nor a step towards monetary financing of the government's deficit. But instead, that it is a temporary intervention with financial stability in mind.
- After a shaky start to the year, the S&P 500 and FTSE 100 climbed in the first half of Q2 2022/23 before falling to their lowest levels since November 2020 and July 2021 respectively. The S&P 500 is 7.2% below its level at the start of the quarter, whilst the FTSE 100 is 5.2% below it as the fall in the pound has boosted the value of overseas earnings in the index. The decline has, in part, been driven by the rise in global real yields and the resulting downward pressure on equity valuations as well as concerns over economic growth leading to a deterioration in investor risk appetite.

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Link Asset Services interest rate forecast

Treasury advisor, Link Asset Services, has provided the following forecast:

Link Group Interest Rate View 27.09.22												
	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25
BANK RATE	4.00	5.00	5.00	5.00	4.50	4.00	3.75	3.25	3.00	2.75	2.75	2.50
3 month ave earnings	4.50	5.00	5.00	5.00	4.50	4.00	3.80	3.30	3.00	2.80	2.80	2.50
6 month ave earnings	4.70	5.20	5.10	5.00	4.60	4.10	3.90	3.40	3.10	3.00	2.90	2.60
12 month ave earnings	5.30	5.30	5.20	5.00	4.70	4.20	4.00	3.50	3.20	3.10	3.00	2.70
5 yr PWLB	5.00	4.90	4.70	4.50	4.20	3.90	3.70	3.50	3.40	3.30	3.20	3.20
10 yr PWLB	4.90	4.70	4.60	4.30	4.10	3.80	3.60	3.50	3.40	3.30	3.20	3.20
25 yr PWLB	5.10	4.90	4.80	4.50	4.30	4.10	3.90	3.70	3.60	3.60	3.50	3.40
50 yr PWLB	4.80	4.60	4.50	4.20	4.00	3.80	3.60	3.40	3.30	3.30	3.20	3.10

The forecast on 27th September sets out a view that both short and long-dated interest rates will be elevated for some little while, as the Bank of England seeks to squeeze inflation out of the economy, whilst the government is providing a package of fiscal loosening to try and protect households and businesses from the ravages of ultra-high wholesale gas and electricity prices.

The increase in PWLB rates reflects a broad sell-off in sovereign bonds internationally but more so the disaffection investors have with the position of the UK public finances after September’s “fiscal event”. To that end, the MPC has tightened short-term interest rates with a view to trying to slow the economy sufficiently to keep the secondary effects of inflation – as measured by wage rises – under control, but its job is that much harder now.

PWLB rate forecasts are based on the Certainty Rate which has been accessible to most authorities since 1st November 2012.

4. Treasury Management Strategy Statement and Annual Investment Strategy update

The Treasury Management Strategy Statement (TMSS) for 2022/23 was approved by the Authority on 14 February 2022. There are no policy changes to the TMSS; the details in this report update the position in the light of the updated economic position and budgetary changes already approved.

Prudential Indicator 2022/23	Original Prudential Indicator	Revised Prudential Indicator
Authorised Limit	£40m	£40m
Operational Boundary	£37m	£37m
Capital Financing Requirement (31.3.22)	£34m	£34m

5. The Authority's Capital Position (Prudential Indicators)

This section of the report provides an update on:

- The Authority's capital expenditure plans;
- How these plans are being financed;
- The impact of the changes in the capital expenditure plans on the prudential indicators and the underlying need to borrow; and
- Compliance with the limits in place for borrowing activity.

Prudential Indicator for Capital Expenditure

The table below shows the capital programme which was approved by the Authority 14 February 2022, it has since been revised to reflect the impact of capital expenditure and financing decisions in 2021/22. The forecast outturn position is as at 30th September 2022.

Capital Expenditure 2022/23	Approved Feb 2022 £000	Revised Estimate £000	Forecast Outturn £000
Land & Buildings:			
Boiler Replacement Programme	15	15	0
Roof Replacements	680	1,091	1,091
Windows & Door Replacements	683	683	669
Rewires	0	175	175
Drill Tower/Training Facilities	624	635	195
Other Building Modifications	0	11	10
Security Works	32	47	47
HQ Alterations	0	120	120
Occupational Health Works	0	17	12
Aston Fire Station	0	61	61
Vehicles:			
Vehicle Replacement Programme	3,191	3,576	3,086
ICT & Equipment:			
C+C Upgrade – Vision 4/ESMCP	0	149	149
Total	5,225	6,580	5,615

Changes to the Financing of the Capital Programme

The table below draws together the main strategy elements of the capital expenditure plans and the expected financing arrangements of this capital expenditure. The borrowing element of the table increases the underlying indebtedness of the Authority by way of the Capital Financing Requirement (CFR), although this will be reduced in part by revenue charges for the repayment of debt (the Minimum Revenue Provision). This direct borrowing need may also be supplemented by maturing debt and other treasury requirements.

Capital Expenditure 2022/23	Approved Feb 2022 £000	Revised Estimate £000	Forecast Outturn £000
Total Spend	5,225	6,580	5,615
Financed by:			
Capital Receipts	0	0	0
Capital Grants / Contributions	0	74	74
Revenue Contribution to Capital	5,225	6,506	5,541
Total Financing	5,225	6,580	5,615
Borrowing Need	0	0	0

Changes to the Prudential Indicators for the CFR, External Debt and the Operational Boundary

The table below shows the CFR, which is the underlying external need to incur borrowing for a capital purpose. It also shows the expected debt position over the period. This is termed the Operational Boundary.

Prudential Indicator – CFR

The Authority is on target to achieve the original forecast CFR.

Prudential Indicator – External Debt / the Operational Boundary

	2022/23 Original Estimate	2022/23 Revised Estimate
Prudential Indicator – CFR		
Total CFR (31.3.22)	£34m	£34m
Prudential Indicator – External Debt / the Operational Boundary		
Borrowing	£37m	£37m
Total debt 31 March 2022	£32m	£32m

Limits to Borrowing Activity

The first key control over the treasury activity is a prudential indicator to ensure that over the medium term, net borrowing (borrowings less investments) will only be for a capital purpose. Gross external borrowing should not, except in the short term, exceed the total of CFR in the preceding year plus the estimates of any additional CFR for 2022/23 and next two financial years. This allows some flexibility for limited early borrowing for future years. The Authority has approved a policy for borrowing in advance of need which will be adhered to if this proves prudent.

	2022/23 Original Estimate	2022/23 Revised Estimate
Gross borrowing (Excluding Ex WMCC)	£30m	£30m
CFR (31.3.22)	£34m	£34m

The Treasurer reports that no difficulties are envisaged for the current or future years in complying with this prudential indicator.

A further prudential indicator controls the overall level of borrowing. This is the Authorised Limit which represents the limit beyond which borrowing is prohibited and needs to be set and revised by Members. It reflects the level of borrowing which, while not desired, could be afforded in the short term, but is not sustainable in the longer term. It is the expected maximum borrowing need with some headroom for unexpected movements. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003.

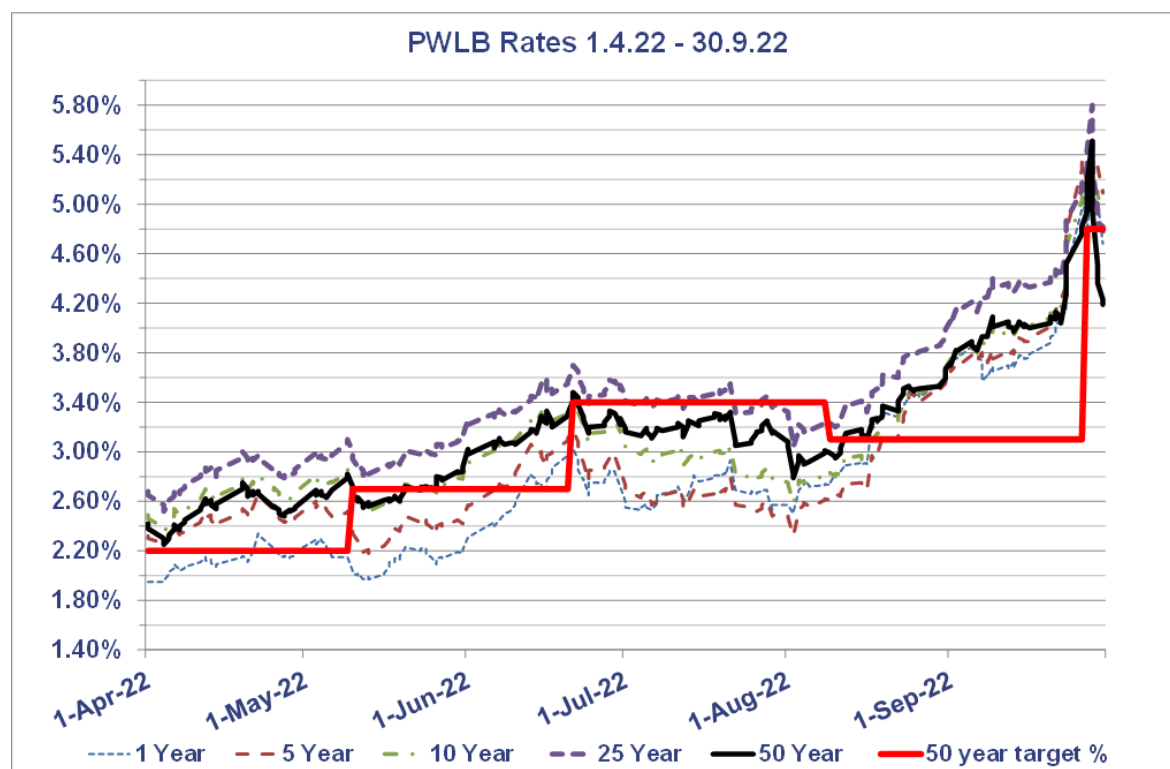
Authorised limit for external debt	2022/23 Original Indicator	2022/23 Revised Indicator
Borrowing	£40m	£40m

6. Borrowing

The Authority's CFR for 2022/23 is £34m (31.3.22). The CFR denotes the Authority's underlying need to borrow for capital purposes. If the CFR is positive the Authority may borrow from the PWLB or the market (external borrowing) or from internal balances on a temporary basis (internal borrowing). The balance of external and internal borrowing is generally driven by market conditions.

It is not anticipated that borrowing will be undertaken during this financial year however this requirement will be monitored by the Treasurer as part of the capital financing decisions.

The graph below shows the movement in PWLB rates for the first six months of the year:



	1 Year	5 Year	10 Year	25 Year	50 Year
Low	1.95%	2.18%	2.36%	2.52%	2.25%
Date	01/04/2022	13/05/2022	04/04/2022	04/04/2022	04/04/2022
High	5.11%	5.44%	5.35%	5.80%	5.51%
Date	28/09/2022	28/09/2022	28/09/2022	28/09/2022	28/09/2022
Average	2.81%	2.92%	3.13%	3.44%	3.17%
Spread	3.16%	3.26%	2.99%	3.28%	3.26%

7. Debt Rescheduling

Debt rescheduling opportunities have been very limited in the current economic climate and following the various increases in the margins added to gilt yields which have impacted PWLB new borrowing rates since October 2010. No debt rescheduling has therefore been undertaken to date in the current financial year. However, now that the whole of the yield curve has shifted higher there may be better opportunities in the future, although only prudent and affordable debt rescheduling will be considered.

8. Compliance with Treasury and Prudential Limits

It is a statutory duty for the Authority to determine and keep under review the affordable borrowing limits. During the half year ended 30th September 2022, the Authority has operated within the treasury and prudential indicators set out in the Authority's Treasury Management Strategy Statement for 2022. The Treasurer reports that no difficulties are envisaged for the current or future years in complying with these indicators.

All treasury management operations have also been conducted in compliance with the Authority's Treasury Management Practices.

9. Investment Portfolio 2022/23

The Treasury Management Strategy Statement (TMSS) for 2022/23, which includes the Annual Investment Strategy, was approved by the Authority on 14 February 2022. In accordance with the CIPFA Treasury Management Code of Practice, it sets out the Authority's investment priorities as being:

- Security of capital
- Liquidity
- Yield

The Authority will aim to achieve the optimum return (yield) on its investments commensurate with proper levels of security and liquidity and with the Authority's risk appetite. In the current economic climate, it is considered appropriate to keep investments short term to cover cash flow needs, but also to seek out value available in periods up to 12 months with high credit rated financial institutions, using the Link suggested creditworthiness approach.

Investment Counterparty Criteria

The current investment counterparty criteria selection approved in the TMSS is meeting the requirement of the treasury management function.

Investment Balances

The Authority held £52.2m of investments as at 30 September 2022 (£33.5m at 31 March 2022) and the investment portfolio yield for the first six months of the year is 1.35% against a benchmark average SONIA (Sterling Overnight Index Average) rate of 1.22%.

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The Treasurer confirms that the approved limits within the Annual Investment Strategy were not breached during the first six months of 2022/23.

The Authority's budgeted investment return for 2022/23 is £0.120m, and performance for the year to date is estimated to be £0.420m above budget

10. Other

Changes in risk appetite

The 2018 CIPFA Codes and guidance notes have placed enhanced importance on risk management. Where an authority changes its risk appetite e.g., for moving surplus cash into or out of certain types of investment funds or other types of investment instruments, this change in risk appetite and policy should be brought to members' attention in treasury management update reports.