APPENDIX

WEST MIDLANDS FIRE SERVICE

Treasury Management Strategy Statement and Annual Investment Strategy

Mid-year Review Report 2020/21

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 2011 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 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 2020/21;

- A review of the Treasury Management Strategy Statement and Annual Investment Strategy;

- The Authority's capital expenditure (prudential indicators);

- A review of the Authority's investment portfolio for 2020/21;

- A review of the Authority's borrowing strategy for 2020/21;

- A review of any debt rescheduling undertaken during 2020/21;

- A review of compliance with Treasury and Prudential Limits for 2020/21.

3. Economic update

UK. As expected, the Bank of England's Monetary Policy Committee kept Bank Rate unchanged on 6th August. It also kept unchanged the level of quantitative easing at £745bn. Its forecasts were optimistic in terms of three areas:

- The fall in GDP in the first half of 2020 was revised from 28% to 23% (subsequently revised to -21.8%). This is still one of the largest falls in output of any developed nation. However, it is only to be expected as the UK economy is heavily skewed towards consumer-facing services – an area which was particularly vulnerable to being damaged by lockdown.
- The peak in the unemployment rate was revised down from 9% in Q2 to 7½% by Q4 2020.
- It forecast that there would be excess demand in the economy by Q3 2022 causing CPI inflation to rise above the 2% target in Q3 2022, (based on market interest rate expectations for a further loosening in policy). Nevertheless, even if the Bank were to leave policy unchanged, inflation was still projected to be above 2% in 2023.

It also squashed any idea of using negative interest rates, at least in the next six months or so. It suggested that while negative rates can work in some circumstances, it would be “less effective as a tool to stimulate the economy” at this time when banks are worried about future loan losses. It also has “other instruments available”, including QE and the use of forward guidance.

The MPC expected the £300bn of quantitative easing purchases announced between its March and June meetings to continue until the “turn of the year”. This implies that the pace of purchases will slow further to about £4bn a week, down from £14bn a week at the height of the crisis and £7bn more recently.

In conclusion, this would indicate that the Bank could now just sit on its hands as the economy was recovering better than expected. However, the MPC acknowledged that the “medium-term projections were a less informative guide than usual” and the minutes had multiple references to downside risks, which were judged to persist both in the short and medium term. One has only to look at the way in which second waves of the virus are now impacting many countries including Britain, to see the dangers. However, rather than a national lockdown, as in March, any spikes in virus infections are now likely to be dealt with by localised measures and this should limit the amount of economic damage caused. In addition, Brexit uncertainties ahead of the year-end deadline are likely to be a drag on recovery. The wind down of the initial generous furlough scheme through to the end of October is another development that could cause the Bank to review the need for more support for the economy later in the year. Admittedly, the Chancellor announced in late September a second six-month package from 1st November of government support for jobs whereby it will pay up to 22% of the costs of retaining an employee working a minimum of one third of their normal hours. There was further help for the self-employed, freelancers and the hospitality industry. However, this is a much less generous scheme than the furlough package and will inevitably mean there will be further job losses from the 11% of the workforce still on furlough in mid-September.

Overall, the pace of recovery is not expected to be in the form of a rapid V shape, but a more elongated and prolonged one after a sharp recovery in June through to August which left the economy 11.7% smaller than in February. The last three months of 2020 are now likely to show no growth as consumers will probably remain cautious in spending and uncertainty over the outcome of the UK/EU trade negotiations concluding at the end of the year will also be a headwind. If the Bank felt it did need to provide further support to recovery, then it is likely that the tool of choice would be more QE.

There will be some painful longer-term adjustments as e.g. office space and travel by planes, trains and buses may not recover to their previous level of use for several years, or possibly ever. There is also likely to be a reversal of globalisation as this crisis has shown up how vulnerable long-distance supply chains are. On the other hand, digital services are one area that has already seen huge growth.

One key addition to the Bank's forward guidance 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.

EU. The economy was recovering well towards the end of Q2 after a sharp drop in GDP, (e.g. France 18.9%, Italy 17.6%). However, the second wave of the virus affecting some countries could cause a significant slowdown in the pace of recovery, especially in countries more dependent on tourism. The fiscal support package, eventually agreed by the EU after prolonged disagreement between various countries, is unlikely to provide significant support and quickly enough to make an appreciable difference in weaker countries. The ECB has been struggling to get inflation up to its 2% target and it is therefore expected that it will have to provide more monetary policy support through more quantitative easing purchases of bonds in the absence of sufficient fiscal support.

Link Asset Services interest rate forecast

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

Link Group Interest Rate View 11.8.20										
	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23
Bank Rate View	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
3 month average earnings	0.05	0.05	0.05	0.05	0.05	-	-	-	-	-
6 month average earnings	0.10	0.10	0.10	0.10	0.10	-	-	-	-	-
12 month average earnings	0.15	0.15	0.15	0.15	0.15	-	-	-	-	-
5yr PWLB Rate	1.90	2.00	2.00	2.00	2.00	2.00	2.10	2.10	2.10	2.10
10yr PWLB Rate	2.10	2.10	2.10	2.10	2.20	2.20	2.20	2.30	2.30	2.30
25yr PWLB Rate	2.50	2.50	2.50	2.60	2.60	2.60	2.70	2.70	2.70	2.70
50yr PWLB Rate	2.30	2.30	2.30	2.40	2.40	2.40	2.50	2.50	2.50	2.50

The coronavirus outbreak has done huge economic damage to the UK and economies around the world. After the Bank of England took emergency action in March to cut Bank Rate to first 0.25%, and then to 0.10%, it left Bank Rate unchanged at its meeting on 6th August (and the subsequent September meeting), although some forecasters had suggested that a cut into negative territory could happen. However, the Governor of the Bank of England has made it clear that he currently thinks that such a move would do more damage than good and that more quantitative easing is the favoured tool if further action becomes necessary. As shown in the forecast table above, no increase in Bank Rate is expected within the forecast horizon ending on 31st March 2023 as economic recovery is expected to be only gradual and therefore, prolonged.

The Balance of Risks to the UK
The overall balance of risks to economic growth in the UK is probably relatively even, but is subject to major uncertainty due to the virus.

There is relatively little UK domestic risk of increases or decreases in Bank Rate and significant changes in shorter term PWLB rates. The Bank of England has effectively ruled out the use of negative interest rates in the near term and increases in Bank Rate are likely to be some years away given the underlying economic expectations. However, it is always possible that safe haven flows, due to unexpected domestic developments and those in other major economies, could impact gilt yields, (and so PWLB rates), in the UK.

Downside Risks to Current Forecasts for UK
UK - second nationwide wave of virus infections requiring a national lockdown.

UK / EU trade negotiations – if it were to cause significant economic disruption and a fresh major downturn in the rate of growth.

UK - Bank of England takes action too quickly, or too far, over the next three years to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than we currently anticipate.

4. Treasury Management Strategy Statement and Annual Investment Strategy update

The Treasury Management Strategy Statement (TMSS) for 2020/21 was approved by the Authority on 17 February 2020. 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 2020/21	Original Prudential Indicator	Revised Prudential Indicator
Authorised Limit	£43m	£43m
Operational Boundary	£39m	£39m
Capital Financing Requirement (31.3.20)	£36m	£36m

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 17 February 2020, it has since been revised to reflect the impact of capital expenditure and financing decisions in 2019/20. The forecast outturn position is as at 30th September 2020.

Capital Expenditure 2020/21	Approved Feb 2020 £000	Revised Estimate £000	Forecast Outturn £000
Land & Buildings:			
Coventry Fire Station	0	84	84
Aston Fire Station	412	675	589
Occupational Health Relocation	0	60	60
Boiler Replacement Programme	245	348	367
Roof Replacements	87	87	87
Windows & Door Replacements	531	531	14
Rewires	110	385	329
Drill Tower/Training Facilities	525	526	526
Security Works	0	105	105
Health & Safety Work (COVID)	0	155	155
Vehicles:			
Vehicle Replacement Programme	4,154	4,215	2,659
ICT & Equipment:			
Enterprise Resources Planning	500	499	499
C+C Upgrade – Vision 4/ESMCP	0	407	407
Total	**6,564**	**8,077**	**5,881**

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 2020/21	**Approved Feb 2020 £000**	**Revised Estimate £000**	**Forecast Outturn £000**
Total Spend	**6,564**	**8,077**	**5,881**
Financed by:			
Capital Receipts	0	0	0
Capital Grants / Contributions	0	74	74
Revenue Contribution to Capital	6,564	8,003	5,807
Total Financing	**6,564**	**8,077**	**5,881**
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

	2020/21 Original Estimate		**2020/21 Revised Estimate**
Prudential Indicator – CFR			
Total CFR (31.3.20)	£36m		£36m
Prudential Indicator – External Debt / the Operational Boundary			
Borrowing	£39m		£39m
Total debt 31 March 2020	£36m		£36m

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 2020/21 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.

	2019/20 Original Estimate	2019/20 Revised Estimate
Gross borrowing (Excluding Ex WMCC)	£33m	£33m
CFR (31.3.20)	£36m	£36m

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.

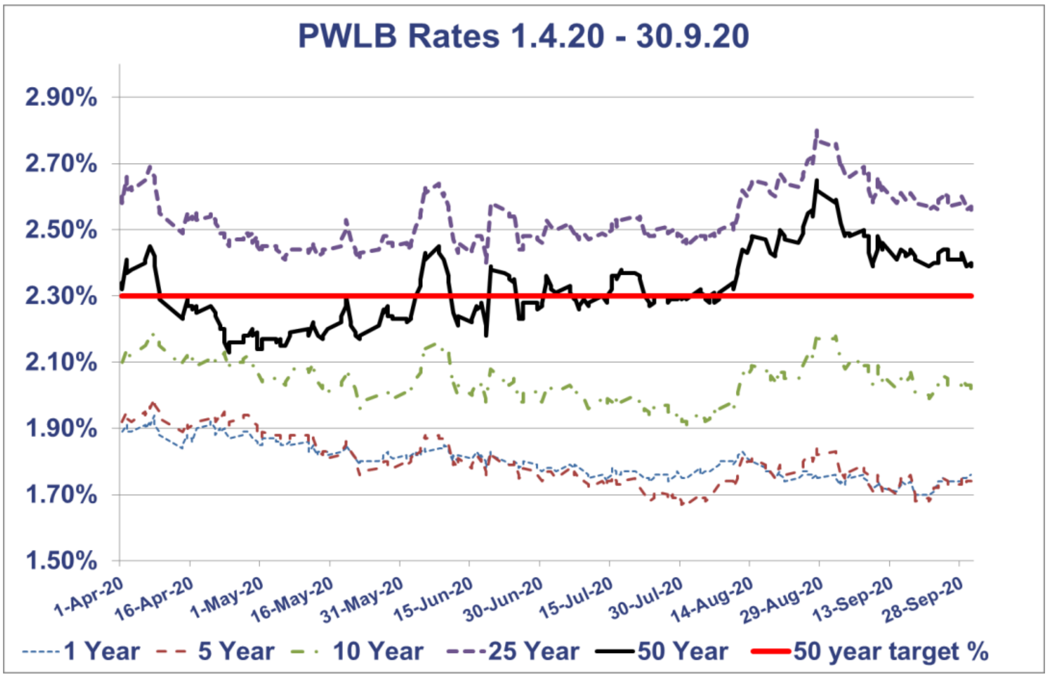
Authorised limit for external debt	2020/21 Original Indicator	2020/21 Revised Indicator
Borrowing	£43m	£43m

6. Borrowing

The Authority's CFR for 2020/21 is £36m (31.3.20). 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	1.70%	1.67%	1.91%	2.40%	2.13%
Date	18/09/2020	30/07/2020	31/07/2020	18/06/2020	24/04/2020
High	1.94%	1.99%	2.19%	2.80%	2.65%
Date	08/04/2020	08/04/2020	08/04/2020	28/08/2020	28/08/2020
Average	1.80%	1.80%	2.04%	2.54%	2.33%

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.

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 2020, the Authority has operated within the treasury and prudential indicators set out in the Authority's Treasury Management Strategy Statement for 2020. The Treasurer reports that no difficulties are envisaged for the current or future years in complying with these indicators

9. Investment Portfolio 2020/21

The Treasury Management Strategy Statement (TMSS) for 2020/21, which includes the Annual Investment Strategy, was approved by the Authority on 17 February 2020. 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.

As shown by the interest rate forecasts in section 3, it is now impossible to earn the level of interest rates commonly seen in previous decades as all investment rates are barely above zero now that Bank Rate is at 0.10%, while some entities, including more recently the Debt Management Account Deposit Facility (DMADF), are offering negative rates of return in some shorter time periods. Given this risk environment and the fact that increases in Bank Rate are unlikely to occur before the end of the current forecast horizon of 31st March 2023, investment returns are expected to remain low.

While the Bank of England has said that it is unlikely to introduce a negative Bank Rate, at least in the next 6-12 months, some deposit accounts are already offering negative rates for shorter periods. As part of the response to the pandemic and lockdown, the Bank and the Government have provided financial markets and businesses with plentiful access to credit, either directly or through commercial banks. In addition, the Government has provided large sums of grants to local authorities to help deal with the Covid crisis; this has caused some local authorities to have sudden large increases in investment balances.

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 £61m of investments as at 30 September 2020 (£45.6m at 31 March 2020) and the investment portfolio yield for the first six months of the year is 0.327% against a benchmark (average 3-month LIBID rate) of 0.11%.

The Treasurer confirms that the approved limits within the Annual Investment Strategy were not breached during the first six months of 2020/21.

The Authority's budgeted investment return for 2020/21 is £0.300m, and performance for the year to date is estimated to be £0.200m below budget

9. 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.