WEST MIDLANDS FIRE AND RESCUE AUTHORITY

AUDIT AND RISK COMMITTEE

24 JULY 2023

1. TREASURY MANAGEMENT – ANNUAL REPORT 2022/2023

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 2022/2023 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 annual treasury report covers the treasury activity during 2022/2023 and the actual Prudential Indicators for 2022/2023.

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 2022/2023.

3.2 Appendix A, the Annual Treasury Management Report 2022/2023 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 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 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 2022
Treasury Management Mid-Year Report – Audit and Risk Committee November 2022
Link Treasury Services – Treasury Management Bulletins and Newsletters

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

MIKE GRIFFITHS
TREASURER

APPENDIX A

WEST MIDLANDS FIRE SERVICE

Annual Treasury Management Review 2022/23

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 2022/23. 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 2022/23 the minimum reporting requirements were that the Authority should receive the following reports:

- an annual treasury strategy in advance of the year (Authority 14/02/2022)
- a mid-year treasury update report (Audit & Risk Committee 28/11/2022)
- 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 2022/23 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	2021/22	2022/23
Actual capital expenditure	£3.189m	£2.419m
Total Capital Financing Requirement	£34.327m	£33.270m
Financing costs to net revenue stream	2.5%	1.6%

The Treasurer confirms that no borrowing was undertaken for any capital purpose during 2022/23 and that the statutory borrowing limit (the authorised limit), was not breached.

As at 31st March 2023, the Authority's external debt was £30.707m (£31.534m as at 31st March 2022) and its investment totalled £26.413m (£33.455m as at 31st March 2022).

2. The Economy and Interest Rates

UK. Economy

Against a backdrop of stubborn inflationary pressures, the easing of Covid restrictions in most developed economies, the Russian invasion of Ukraine, and a range of different UK Government policies, it is no surprise that UK interest rates have been volatile right across the curve, from Bank Rate through to 50-year gilt yields, for all of 2022/23.

Market commentators' misplaced optimism around inflation has been the root cause of the rout in the bond markets with, for example, UK, EZ and US 10-year yields all rising by over 200bps in 2022. The table below provides a snapshot of the conundrum facing central banks: inflation is elevated but labour markets are extra-ordinarily tight, making it an issue of fine judgment as to how far monetary policy needs to tighten.

	UK	Eurozone	US
Bank Rate	4.25%	3%	4.75%-5%
GDP	0.1%q/q Q4 (4.1%y/y)	+0.1%q/q Q4 (1.9%y/y)	2.6% Q4 Annualised
Inflation	10.4%y/y (Feb)	6.9%y/y (Mar)	6.0%y/y (Feb)
Unemployment Rate	3.7% (Jan)	6.6% (Feb)	3.6% (Feb)

Q2 of 2022 saw UK GDP deliver growth of +0.1% q/q, but this was quickly reversed in the third quarter, albeit some of the fall in GDP can be placed at the foot of the extra Bank Holiday in the wake of the Queen's passing. Q4 GDP was positive at 0.1% q/q. Most recently, January saw a 0.3% m/m increase in GDP as the number of strikes reduced compared to December. In addition, the resilience in activity at the end of 2022 was, in part, due to a 1.3% q/q rise in real household disposable incomes. A big part of that reflected the £5.7bn payments received by households from the government under the Energy Bills Support Scheme.

Nevertheless, CPI inflation picked up to what should be a peak reading of 11.1% in October, although hopes for significant falls from this level will very much rest on the movements in the gas and electricity markets, as well as the supply-side factors impacting food prices. On balance, most commentators expect the CPI measure of inflation to drop back towards 4% by the end of 2023. As of February 2023, CPI was 10.4%.

The UK unemployment rate fell through 2022 to a 48-year low of 3.6%, and this despite a net migration increase of c500k. The fact remains, however, that with many economic participants registered as long-term sick, the UK labour force shrunk by c500k in the year to June. Without an increase in the labour force participation rate, it is hard to see how the UK economy will be able to grow its way to prosperity, and with average wage increases running at over 6% the MPC will be concerned that wage inflation will prove just as sticky as major supply-side shocks to food (up 18.3% y/y in February 2023) and energy that have endured since Russia's invasion of Ukraine on 22 February 2022.

Bank Rate increased steadily throughout 2022/23, starting at 0.75% and finishing at 4.25%.

In the interim, following a Conservative Party leadership contest, Liz Truss became Prime Minister for a tumultuous seven weeks that ran through September and October. Put simply, the markets did not like the unfunded tax-cutting and heavy spending policies put forward by her Chancellor, Kwasi Kwarteng, and their reign lasted barely seven weeks before being replaced by Prime Minister Rishi Sunak and Chancellor Jeremy Hunt. Their Autumn Statement of the 17th of November gave rise to a net £55bn fiscal tightening, although much of the "heavy lifting" has been left for the next Parliament to deliver. However, the markets liked what they heard, and UK gilt yields have reversed the increases seen under the previous tenants of No10/11 Downing Street, although they remain elevated in line with developed economies generally.

As noted above, GDP has been tepid throughout 2022/23, although the most recent composite Purchasing Manager Indices for the UK, US, EZ and China have all surprised to the upside, registering survey scores just above 50 (below suggests economies are contracting, and above suggests expansion). Whether that means a shallow recession, or worse, will be avoided is still unclear. Ultimately, the MPC will want to see material evidence of a reduction in inflationary pressures and a loosening in labour markets. Realistically, that is an unlikely outcome without unemployment rising and wage settlements falling from their current levels. At present, the bigger rise in employment kept the ILO unemployment rate unchanged at 3.7% in January. Also, while the number of job vacancies fell for the ninth consecutive month in February, they remained around 40% above pre-pandemic levels.

Link Treasury Services economic analysts, Capital Economics, expect real GDP to contract by around 0.2% q/q in Q1 and forecast a recession this year involving a 1.0% peak-to-trough fall in real GDP.

The £ has remained resilient of late, recovering from a record low of $1.035, on the Monday following the Truss government's "fiscal event", to $1.23. Notwithstanding the £'s better run of late, 2023 is likely to see a housing correction of some magnitude as fixed-rate mortgages have moved above 4.5% and affordability has been squeezed despite proposed Stamp Duty cuts remaining in place.

As for equity markets, the FTSE 100 started 2023 strongly, rising to a record high of 8,014 on 20th February, as resilient data and falling inflation boosted earnings. But global equities fell sharply after concerns over the health of the global banking system emerged early in March. The fall in the FTSE 100 was bigger than the drop in the US S&P 500. Indeed, at around 7,600 now, the FTSE is 5.2% below its record high on 20th February, while the S&P 500 is only 1.9% lower over the same period. That's despite UK banks having been less exposed and equity prices in the UK's financial sector not falling as far. It may be due to the smaller decline in UK interest rate expectations and bond yields, which raise the discounted value of future earnings, compared to the US.

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.

	2021/22 Actual £m	2022/23 Actual £m
Total capital expenditure	**3.189**	**2.419**
Resourced by:		
• Capital receipts	0.000	0.000
• Capital grants	0.000	0.031
• Revenue Contribution to Capital	3.189	2.388
Capital Expenditure Financed from Borrowing	**0**	**0**

4. Overall Treasury Position as at 31 March 2023

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 2022/23 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 2022/23 was approved 14 February 2022.

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

CFR	31 March 2022 Actual £m	31 March 2023 Actual £m
Opening balance	35.322	34.327
Add unfinanced capital expenditure	0	0
Less MRP	(0.995)	(1.057)
Less VRP	0	0
Closing balance	34.327	33.270

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 (2022/23) plus the estimates of any additional capital financing requirement for the current (2023/24) 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 2022/23.

	31 March 2022 Actual £m	31 March 2023 Actual £m
External Debt	31.534	30.707
Investments	33.455	26.413
Net Borrowing Position	(1.921)	4.294
CFR	34.327	33.270

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 2022/23 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.

	2021/22	2022/23
Authorised limit	£42m	£40m
Operational boundary	£38m	£37m
Maximum gross borrowing position	£34m	£33m
Financing costs as a proportion of net revenue stream	2.5%	1.6%

5. Overall Treasury Position as at 31 March 2023

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 2022 Principal £m	Rate/ Return	31 March 2023 Principal £m	Rate/ Return
Fixed Rate Loans:				
PWLB	*£29.6*	*5.22%*	*£29.2*	*5.20%*
Ex WMCC	*£1.9*	*5.51%*	*£1.5*	*5.38%*
Total Debt	*£31.5*	*5.24%*	*£30.7*	*5.21%*
CFR	*£34.3*		*£33.3*	
Over / (under) borrowing	*(£2.8)*		*(£2.6)*	
Investments:				
Sandwell MBC	*£33.5*	*0.16%*	*£26.4*	*2.34%*
Net Debt	(£2.0)		£4.3	

The maturity structure of the debt portfolio was as follows:

	31 March 2022 Actual £m	31 March 2023 Actual £m
Under 12 months	0.827	0.868
12 months and within 24 months	0.867	0.490
24 months and within 5 years	2.338	2.649
5 years and within 10 years	0.802	0
10 years and above	26.700	26.700

6. The Strategy for 2022/23

Investment returns picked up throughout the course of 2022/23 as central banks, including the Bank of England, realised that inflationary pressures were not transitory, and that tighter monetary policy was called for.

Starting April at 0.75%, Bank Rate moved up in stepped increases of either 0.25% or 0.5%, reaching 4.25% by the end of the financial year, with the potential for further increases in 2023/24.

The sea-change in investment rates meant local authorities were faced with the challenge of pro-active investment of surplus cash for the first time in over a decade, and this emphasised the need for a detailed working knowledge of cashflow projections so that the appropriate balance between maintaining cash for liquidity purposes, and “laddering” deposits on a rolling basis to lock in the increase in investment rates as duration was extended, became an on-going feature of the investment landscape.

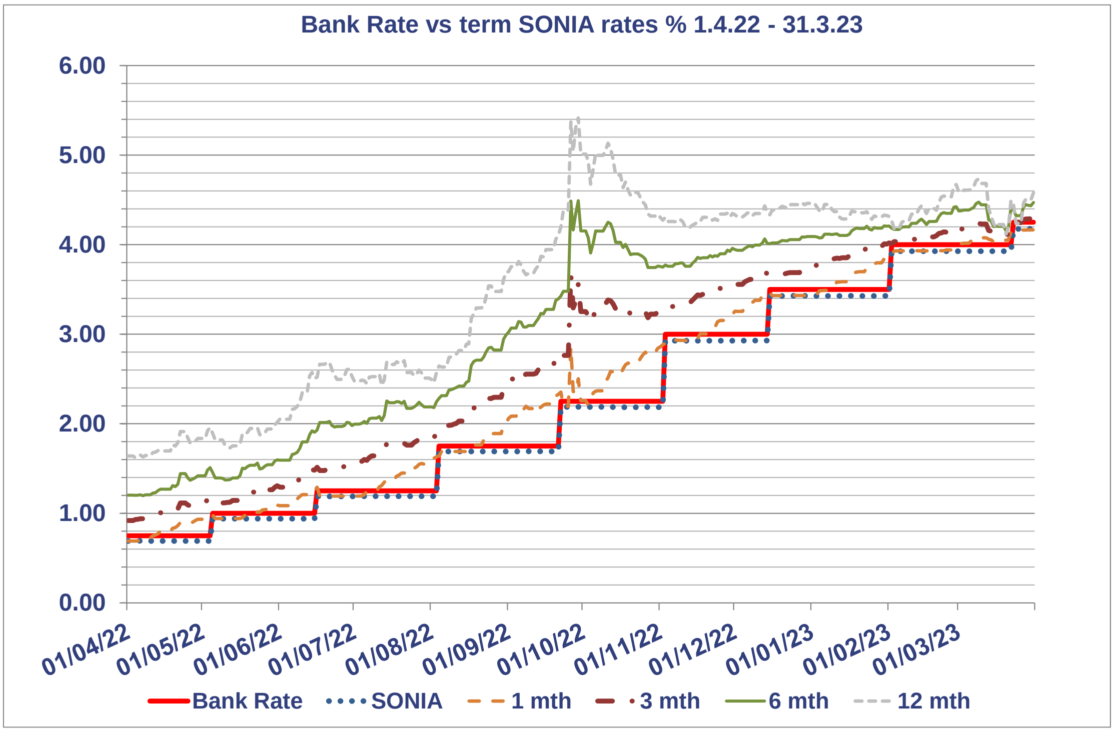
With bond markets selling off, equity valuations struggling to make progress and, latterly, property funds enduring a wretched Q4 2022, the more traditional investment options, such as specified investments (simple to understand, and less than a year in duration) became more actively used.

Meantime, through the autumn, and then in March 2023, the Bank of England maintained various monetary policy easing measures as required to ensure specific markets, the banking system and the economy had appropriate levels of liquidity at times of stress.

Nonetheless, 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 Great Financial Crisis of 2008/9. 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 strategy and control of interest rate risk

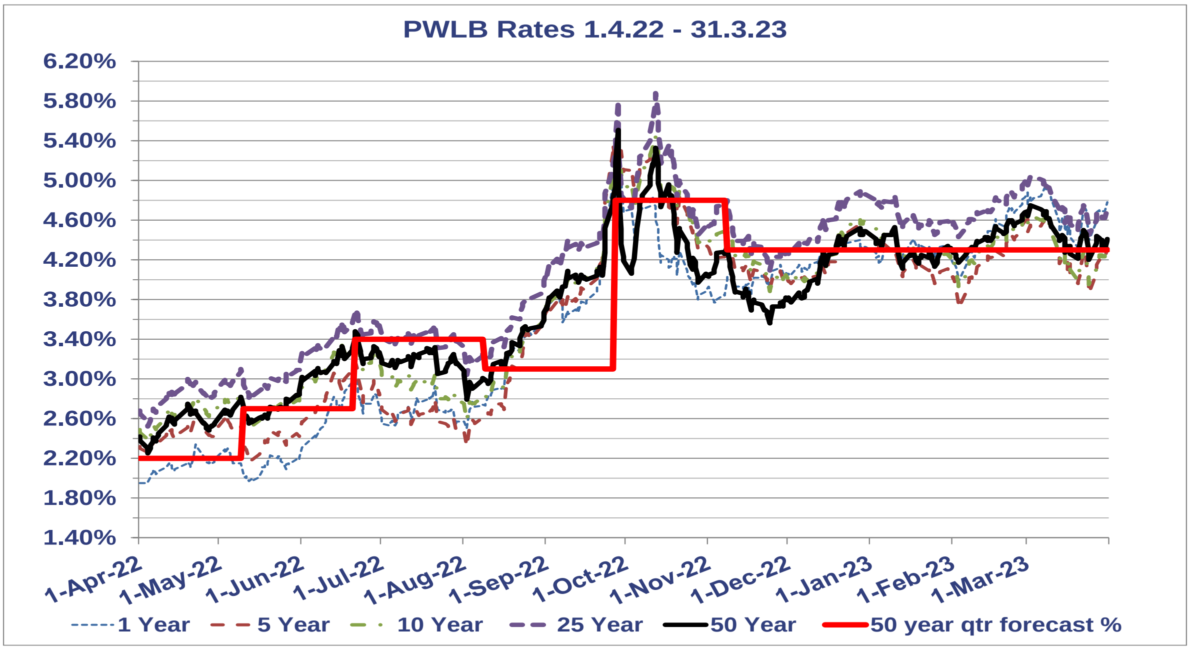
Investment Benchmarking Data – Sterling Overnight Index Averages (Term) 2022/23



FINANCIAL YEAR TO QUARTER ENDED 31/3/2023						
	Bank Rate	**SONIA**	**1 mth**	**3 mth**	**6 mth**	**12 mth**
High	4.25	4.18	4.17	4.30	4.49	5.41
High Date	23/03/2023	31/03/2023	31/03/2023	31/03/2023	29/09/2022	29/09/2022
Low	0.75	0.69	0.69	0.92	1.20	1.62
Low Date	01/04/2022	28/04/2022	01/04/2022	01/04/2022	07/04/2022	04/04/2022
Average	2.30	2.24	2.41	2.72	3.11	3.53
Spread	3.50	3.49	3.48	3.38	3.29	3.79

7. Borrowing Rates in 2022/23

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.



HIGH/LOW/AVERAGE PWLB RATES FOR 2022/23

	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%	5.45%	5.88%	5.51%
Date	28/09/2022	28/09/2022	12/10/2022	12/10/2022	28/09/2022
Average	3.57%	3.62%	3.76%	4.07%	3.74%
Spread	3.16%	3.26%	3.09%	3.36%	3.26%

8. Borrowing Outturn for 2022/23

Borrowing – No borrowing was undertaken during 2022/23.

Rescheduling – No rescheduling was undertaken during 2022/23.

9. Investment Outturn for 2022/23

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 14 February 2022. 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 £41m of internally managed funds. The internally managed funds earned an average rate of return of 2.34%. This compares with a revised budget assumption of £40m investment balances earning an average rate of 1.35%. The investment income was £890k compared to a revised budget of £540k.

The comparable performance indicator for internally managed funds is the average 7-day backward looking SONIA (Sterling Overnight Index Average) uncompounded rate, for which the average was 2.24%. The SONIA replaced the LIBID (London Interbank Bid) rate as a comparable performance indicator in 2021/22.