

**REPORT SUMMARY SHEET
CAPITAL STRATEGY INCLUDING TREASURY MANAGEMENT AND INVESTMENT
STRATEGIES**

Purpose

This report presents the Capital Strategy for the West of England Combined Authority.

Summary

The proposed Capital Strategy for the West of England Combined Authority includes:

- The detailed capital budget for 2019/20, and indicative budget to 2022/23.
- Recommendations for a prioritisation process to develop an indicative 20 year financial allocation for capital investment.
- The Treasury Management Strategy for 2019/20.
- An Investment Strategy for 2019/20

Recommendations

To approve:

- 1. The Capital Budget as shown in Appendices 1 and 2.**
- 2. The proposed method of prioritising capital investment over the next 20 years.**
- 3. The Treasury Management Strategy for 2019/20 detailed in Appendix 3.**
- 4. The Investment Strategy for 2019/20 as shown in Appendix 4**

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REPORT TO: WECA COMMITTEE

DATE: 1 FEBRUARY 2019

**REPORT TITLE: CAPITAL STRATEGY INCLUDING TREASURY
MANAGEMENT & INVESTMENT STRATEGIES**

**DIRECTOR: MALCOLM COE, DIRECTOR OF INVESTMENT AND
CORPORATE SERVICES**

AUTHOR: MALCOLM COE

Purpose of Report

1. This report presents the Capital Strategy for the West of England Combined Authority including;
 - The detailed capital budget for 2019/20, and indicative budget to 2022/23
 - Recommendations for a prioritisation process to develop an indicative 20 year financial allocation for capital investment
 - The Treasury Management Strategy for 2019/20
 - An Investment Strategy for 2019/20

Recommendation:

The WECA Committee is requested to approve:

- a) the Capital Budget as shown in Appendices 1 and 2;
- b) the proposed method of prioritising capital investment over the next 20 years;
- c) the Treasury Management Strategy for 2019/20 detailed in Appendix 3
- d) the Investment Strategy for 2019/20 as shown in Appendix 4

Background / Issues for Consideration

2.1.1 The capital strategy is a new report introduced by the 2017 edition of the Prudential Code. As explained in paragraph 21 of the code, “the capital strategy is intended to give a high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services along with an overview of how associated risk is managed and the implications for future financial sustainability.”

2.1.2 The areas covered by the capital strategy are as follows;

- Medium term capital expenditure and financing (Appendices 1 & 2);
- Longer term capital prioritisation strategy for the next 20 years;
- Treasury management including prudential indicators (Appendix 3);
- Investment strategy for non-treasury investments (Appendix 4);
- Liabilities, revenue implications of the capital programme, and knowledge and skills employed in delivering the strategy.

2.1.3 There is a clear link between this strategy and the financial impact upon various elements of the Authority’s revenue budget, for example, the investment and treasury strategies are key components upon how much interest the Authority could achieve on its investments compared to budgeted levels.

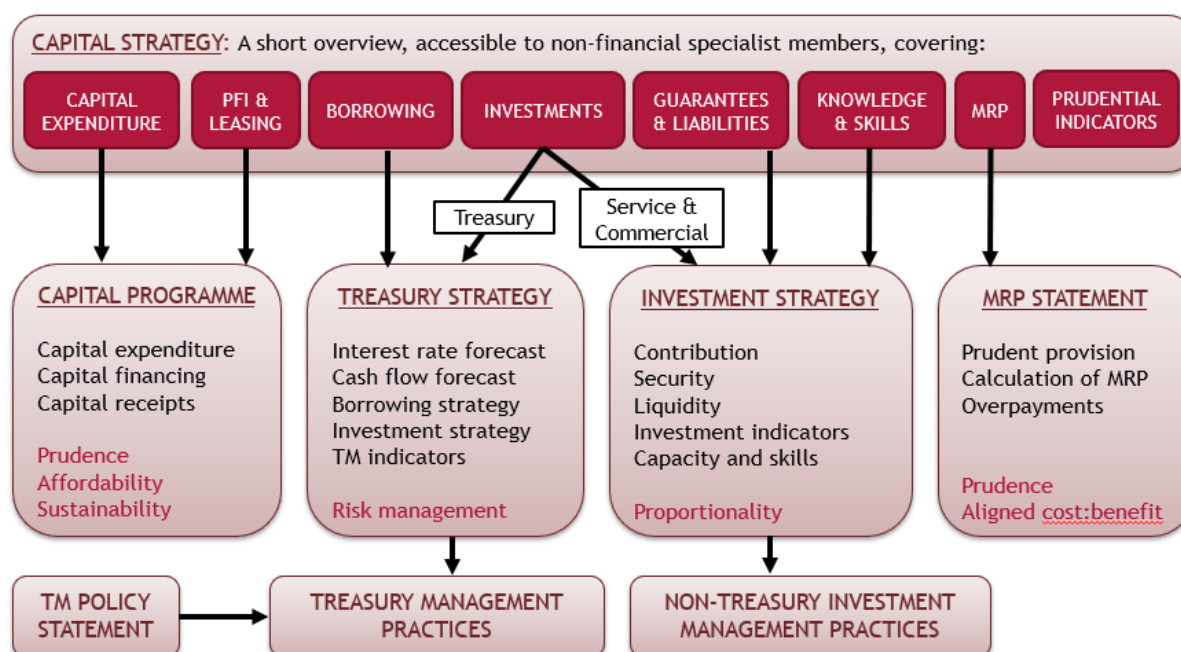
2.1.4 MHCLG published updated *Guidance on Local Government Investments* in February 2018. The previous edition covered treasury investments only, but the current edition focuses on non-treasury investments including:

- loans made for service purposes
- shares in companies bought for service purposes
- loans to and shares in subsidiaries, irrespective of the purpose of the company
- non-financial assets, (e.g. property), held primarily or partially to generate a profit

2.1.5 It is now recommended that these components are included under an overarching capital strategy covering all interlinked capital programme, financing, treasury and investment policies and decisions, both in the short and medium term;

Figure 1: Prudential Code (2017) recommended reporting structure

Strategy Reports: England



2.2 Capital Expenditure and Financing

- 2.2.1 Capital expenditure is where the Combined Authority spends money on assets, such as property or vehicles, that will be used for more than one year. In local government this includes spending on assets owned by other bodies, and loans and grants to other bodies enabling them to buy assets. WECA has some limited discretion on what counts as capital expenditure, for example assets costing below £5,000 are not capitalised and are charged to revenue in year.
- 2.2.2 Costs incurred on developing outline business cases and feasibility work, as a rule, are not able to be capitalised. However, costs incurred on generating full business cases can be capitalised including specific staff costs, such as project managers or engineers, who are engaged in the development. Support service costs incurred on business case development are required to be treated as revenue.
- 2.2.3 The proposed WECA capital programme shown below assumes the approval at today's Committee of £1.488m of Investment Funding to deliver the Full Business Case for the Wraxall Road Roundabout scheme. This approval is requested in the Investment Fund report elsewhere on the agenda.
- 2.2.4 In 2019/20, the WECA is planning capital expenditure of £39.993m as summarised below:

Figure 2: Prudential Indicator: Estimates of Capital Expenditure in £000s

	2018/19 forecast	2019/20 budget	2020/21 budget	2021/22 budget	2022/23 budget
WECA Capital	18,119	22,421	39,800	* (1,300)	* (15,000)
Mayoral Capital	18,813	17,572	17,572	17,572	17,572
TOTAL	36,932	39,993	57,372	16,272	2,572

* Projecting income from land acquisition fund from 2021/22 onwards

- 2.2.5 Several WECA capital projects are at an early stage of feasibility and design. Various assumptions have therefore been made which could materially change as further development is undertaken.
- 2.2.6 Service investments – Land Acquisition Fund £50m (£47.5m over next 5 years). This £50m Land Acquisition Fund is to support a West of England programme for the delivery of housing and infrastructure through land and property acquisition. The establishment of this fund was approved at the November 2018 WECA Committee, and is further considered in the Investment Strategy element of this report.
- 2.2.7 Priority Infrastructure Schemes £25.4m - this funding will be specifically allocated to support the delivery of business cases from the currently prioritised schemes approved for development.
- 2.2.8 The Mayor is responsible for the payment of £17.572m annual transport related capital grant funding that was previously distributed by the Department for Transport incorporating Highways maintenance grants, highways incentive grants and integrated transport grants. This funding will continue to be allocated to the three West of England councils as per the previous two financial years.
- 2.2.9 The Highways and Transport grants are currently funded through Business Rate Retention within the current WECA pilot scheme. With the new national business rate retention system due for implementation in 2020/21, it is assumed that the £17.572m will revert back to capital grant funding.
- 2.2.10 All new projects requiring approval, (whether delivered externally via grant or delivered internally by WECA), will go through an integrated ‘One Front Door’ approach similar to that established to govern funding from the Local Growth, Economic Development and Revolving Infrastructure funds.
- 2.2.11 All capital expenditure must be financed, either from external sources (government grants and other contributions), the Authority’s own resources

(reserves) or debt (borrowing, leasing and Private Finance Initiative). The planned financing of the budgeted expenditure is as follows:

Figure 3: Capital financing in £000s

	2018/19 forecast	2019/20 budget	2020/21 budget	2021/22 budget	2022/23 budget
Investment Fund Grant	13,069	22,421	39,800	(1,300)	(15,000)
Other Grants	6,241	0	17,572	17,572	17,572
Revenue Contribution	17,622	17,572	0	0	0
TOTAL	36,932	39,993	57,372	16,272	2,572

* Projecting income from land acquisition fund from 2021/22 onwards

2.2.12 There is no intention at this stage for WECA to finance any of its capital spend from long term borrowing. The only borrowing currently being considered is short term borrowing to cover cash flow issues, as detailed within the Treasury Management Strategy (Appendix 3 of this report).

2.3 Developing a 20 Year Capital Strategy

2.3.1 There are a number of significant funding streams that the region has successfully attracted over recent years, each covering different time periods with differing conditions and requirements. A summary of the key areas of funding are detailed in *Figure 4*:

Figure 4: Core West of England regional funding streams

Funding stream	Amount £m	Time Period
Local Growth Fund (LGF)	202.0	Up to March 2021
Economic Development Fund (EDF)	500.0	25 years from 2014/15
Revolving Infrastructure Fund (RIF)	57.0	Revolving
Transforming Cities Fund (TCF)	103.0	2017/18 up to March 2023
Combined Authority Investment Fund	900.0	30 years from 2016/17
Total West of England Region:	1,762.0	

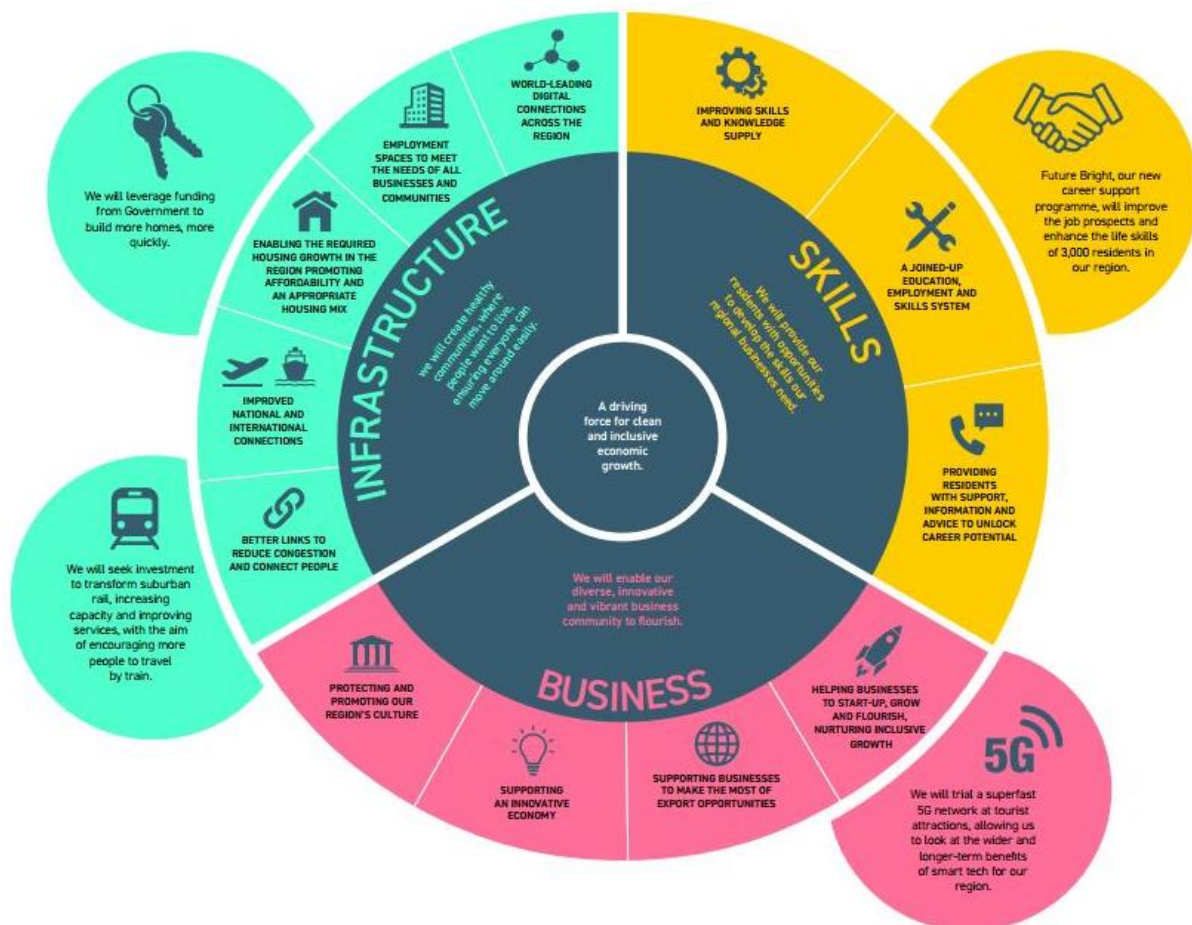
2.3.2 The region has worked collaboratively to prioritise schemes, providing a comprehensive forward programme of work for LGF, EDF and RIF. On occasions, where relevant, individual projects have been ‘switched’ between funding streams to ensure that spend profiles are fully aligned to estimated scheme completion dates.

2.3.3 A similar, long term financial programming approach now needs to be applied to the Investment Fund (30 years) and Transforming Cities Fund (5 years). There are a number of key regional and national strategies and policies that will influence this programming including the:

- Joint Spatial Plan (JSP);
- Joint Local Transport Plan (JLTP);
- Local Industrial Strategy (LIS);
- Skills Strategy

2.3.4 These will need to be aligned and integrated with regional priority outcomes and objectives which are detailed within the published WECA Operating Framework as detailed in **Figure 5**

Figure 5: WECA Operating Framework (2018/19)



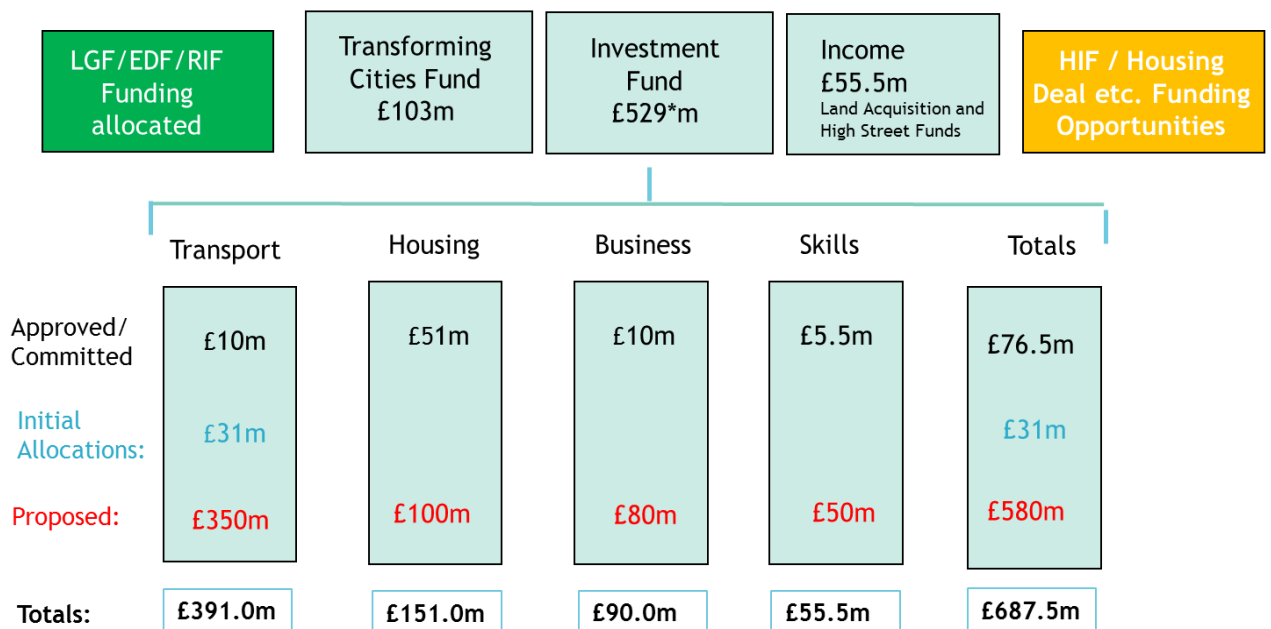
2.3.5 For financial planning purposes, WECA is recommending a 20 year indicative allocation which is conterminous with the strategic JSP and JLTP time period. This longer-term approach to financial planning will need to be flexible and fluid in nature to reflect further funding being attracted into the region alongside emerging and changing priority schemes.

2.3.6 In forming our indicative financial allocations, we have split the ‘Infrastructure’ area to reflect the importance to the region of investment in Transport Infrastructure separate to the priority objective of delivering the required Housing Growth.

2.3.7 High level, 20 year allocations are detailed in *Figure 6*:

Figure 6: Indicative Financial allocations against Regional Priorities

INDICATIVE 20 YEAR FUNDING



* Net of running costs

2.3.8 The key component of our devolution bid was the provision of transport infrastructure for the region which is reflected through the majority of financial allocation to this area.

2.3.9 It is hoped that the recently approved Land Acquisition Fund of £50m, aimed at accelerating housing delivery through public sector intervention, will help to support the WECA’s bid for significant Housing Infrastructure Funding from government. The initial bidding stage for this funding is March 2019.

2.3.10 Smaller indicative allocations have been made to the ‘Business’ and ‘Skills’ area in recognition that a significant amount of Economic Development Funding and Local Growth Funding have already been assigned to these areas in recent years.

2.3.11 The indicative 20 years funding allocation must be viewed as a 'living document' with regular updates and enhancements being made through either:

- (a) Further funding being attracted to the area and added to the overall total for allocation; and/or
- (b) Changing costs and priorities of projects and programmes as feasibility and development work progresses.

2.3.12 To support the objectives and outcomes of the Operating Framework, detailed criteria is being developed for each theme enabling emerging projects to be measured, in terms of core outcome delivery, and prioritised.

2.3.13 Adopting a more structured approach to financial programming for the Investment Fund and Transforming Cities Fund will provide:

- A stronger evidence base to Government in support of the first 5 year, (Investment Fund), gateway review which will commence in 2019;
- An ability to understand the complete picture of projects and programmes delivered across the region with more transparency as to how funding streams and objectives interrelate;
- Greater confidence and flexibility to 'switch' projects between funding streams to ensure that we maximise investment into the region whilst delivering required outcomes;
- Greater assurance that we are prioritising limited resources against projects that deliver the maximum benefit, and
- A framework and approach that can be built upon as and when further funding becomes available.

2.3.14 Against the Investment Fund to date there have been some full project approvals along with some 'in principle' allocations of funding (where the approval is subject to further work in developing the project to full approval). The table below shows the summary position:

Figure 7: Approved and Indicative Capital allocations as at December 2018

Investment Fund & Transforming Cities Funding	5 Yrs to 2020/21 £m	5 Yrs to 2025/26 £m	5 Yrs to 2030/31 £m	5 Yrs to 2035/36 £m	20 Year Total £m
Grant & Revolved Income less assumed running costs	(187.7)	(237.4)	(131.3)	(131.1)	(687.5)
Approved / Committed Schemes	66.5	10	0	0	76.5
In principle allocation	30.0	1.0	0	0	31.0
Balance for allocation	(91.2)	(226.4)	(131.3)	(131.1)	(580)

2.3.15 In addition to the approved and ‘in principle’ allocations WECA, along with BANES Bristol and South Gloucestershire Councils, have developed a ‘long list’ of potential investment projects and programmes that will deliver against the priority objectives of the Operating Framework. The total value of these projects significantly exceed the overall funding available – hence require further refinement and prioritisation prior to publication. However, as an indication, the priority areas where investment will be made will include:

Figure 8: Priority areas for WECA Investment

Theme	Indicative Funding	Investment Priorities
Transport	£350m	<ul style="list-style-type: none"> • Improvements in rail – to include MetroWest and investment in infrastructure and stations; • Improvements and extensions to bus routes linked to the emerging bus strategy (including MetroBus); • Investment in Park and Ride facilities alongside targeted alterations to roads to reduce the volume of traffic; • Significant schemes that encourage more people to choose walking and cycling as opposed to car usage; • Improvements to roads and infrastructure to deliver the required housing and business growth in the region; • Mass transit – exploring new, sustainable public transportation alternatives for the future; • Investment in digital and innovative infrastructure

Theme	Indicative Funding	Investment Priorities
Housing	£100m	<ul style="list-style-type: none"> • Prioritised funding to deliver Joint Spatial Plan and Joint Local Transport Plan priority projects; • Targeted public sector interventions that will accelerate the delivery of housing in the region; • Strategic land acquisition in support of WECA's Housing Infrastructure Fund bid to Government; • Creative use of WECA's 'Land Acquisition Fund' to enable reinvestment into a revolving fund;
Business	£80m	<ul style="list-style-type: none"> • Provision of strategic employment locations. Supporting Enterprise Areas and promoting new strategic sites; • Targeted support in geographical areas of greatest need; • Development of local skills that match with the current, and future, business requirements in key sectors; • Optimising digital investment and the benefit it brings in terms of business opportunities and efficient operations
Skills	£50m	<ul style="list-style-type: none"> • Helping specific groups with low skills and worklessness develop their skills; • Providing universally available employment support - bringing providers together to match local opportunities; • Enhancing further and higher educational capacity and opportunities accessible by all; • Developing careers advice service and increasing apprenticeship opportunities.
Total:	£580m	

2.4 Treasury Management

- 2.4.1 Treasury management is concerned with keeping sufficient, but not excessive, cash available to meet the Authority's spending needs, whilst managing the risks involved. Surplus cash is invested until required, while a shortage of cash will be met by borrowing, to avoid excessive credit balances or overdrafts in the bank current account. The Authority is typically cash rich in the short-term as grant income is often received before it is spent, but these cash surpluses reduce as capital expenditure is incurred.
- 2.4.2 The Authority's Treasury Management Strategy, as detailed in **Appendix 3**, sets out the proposals and guidance that the Authority will use to manage its daily cash-flow activities during the 2019/20 financial year. The Authority must give due regard to the management of these sums, to ensure that it is sufficiently able to balance the daily cash requirements for all operational services whilst still achieving the strategic outcomes required within the medium-term financial plan.
- 2.4.3 The Council's policy on treasury investments is to prioritise security and liquidity over yield, that is to focus on minimising risk rather than maximising returns. Cash that is likely to be spent in the near term is invested securely, for example with the government, other local authorities or selected high-quality banks, to minimise the risk of loss.
- 2.4.4 Money that will be held for longer terms can be invested more widely, including in bonds, shares and property, to balance the risk of loss against the risk of receiving returns below inflation. Both near-term and longer-term investments may be held in pooled funds, where an external fund manager makes decisions on which particular investments to buy and the Council may request its money back at short notice.
- 2.4.5 In the early years of the Combined Authority's operations, holding high cash balances are common practice as early spend on feasibility studies and development work is relatively low compared to the annual allocation of Investment Funding. However, balances will diminish over time as significant construction costs are incurred.

Figure 9: Treasury management investments in £millions

	31.3.2018 actual	31.3.2019 forecast	31.3.2020 budget	31.3.2021 budget	31.3.2022 budget
Near-term investments	£118m	£113m	£113m	£40m	£32m
Longer-term investments	£10m	£20m	£20m	£20m	£20m
TOTAL	£128m	£133m	£133m	£60m	£52m

2.4.6 Decisions on treasury management investment and borrowing are made daily and are therefore delegated to the Director of Investment and Corporate Services and designated staff, who must act in line with the treasury management strategy. Reports on treasury management activity are presented to the WECA committee on a regular basis with the Audit Committee being responsible for scrutinising treasury management decisions.

2.5 Investments for Service Purposes (Non-Treasury Investments)

2.5.1 The Authority may make investments to assist local public services, including making loans to the three constituent authorities. In light of the public service objective, the Authority is willing to take more risk than with treasury investments, however it still plans for such investments to break even after all costs. Potential service investments are described in Appendix 4 - the Investment Strategy 2019/20, and are limited at this stage to the Land Acquisition Fund of £50m.

2.5.2 Decisions on service investments are made by the relevant service manager in consultation with the Director of Investment and Corporate Services and must meet the criteria and limits laid down in the Investment Strategy. Most loans are capital expenditure and purchases will therefore also be approved as part of the capital programme governance.

Knowledge and skills employed in delivering the strategy

2.6.1 The Authority employs professionally qualified and experienced staff in senior positions with responsibility for making capital expenditure, borrowing and investment decisions. For example, the Director of Investment and Corporate Services is a qualified accountant with 35 years' experience.

2.6.2 Where Council staff do not have the knowledge and skills required, use is made of external advisers and consultants that are specialists in their field. The Council currently employs Arlingclose Limited as Treasury Management advisers and PSTax as VAT advisors. This approach is more cost effective than employing such staff directly, and ensures that the Council has access to knowledge and skills commensurate with its risk appetite.

Consultation

3 Consultation has been carried out with Chief Executives, Section 151 Officers and WECA's Monitoring Officer. The 20 year indicative financial allocations have also been discussed with Directors and senior politicians in the region.

Other Options Considered

4 None.

Risk Management/Assessment

5 This report forms a core part of the WECA's governance and risk management process. Members will be aware that there is a direct link between the levels of risk and the levels of return achieved on investment, although there are many other factors which also affect the capital financing budgets. The priority of the Treasury Management Strategy will be the minimisation of risk to safeguard public resources.

Public Sector Equality Duties

6 The public sector equality duty created under the Equality Act 2010 means that public authorities must have due regard to the need to:

- Eliminate unlawful discrimination, harassment and victimization and other conduct prohibited by the Act.
- Advance equality of opportunity between people who share a protected characteristic and those who do not.
- Foster good relations between people who share a protected characteristic and those who do not.

6.1 The Act explains that having due regard for advancing equality involves:

- Removing or minimising disadvantages suffered by people due to their protected characteristics.
- Taking steps to meet the needs of people from protected groups where these are different from the needs of other people.
- Encouraging people from protected groups to participate in public life or in other activities where their participation is disproportionately low.

6.2 The general equality duty therefore requires organisations to consider how they could positively contribute to the advancement of equality and good relations. It requires equality considerations to be reflected in the design of policies and the delivery of services, including policies, and for these issues to be kept under review.

Finance Implications, including economic impact assessment where appropriate:

7 Financial implications are contained throughout the report and impact on both the capital programme, annual revenue budget, as well as the balance sheet.

Advice given by: Malcolm Coe, Director of Investment & Corporate Services

Legal Implications:

- 8 The Budget proposals have been developed in accordance with appropriate Local Government Regulations, including the specific funding and related governance requirements set out in the West of England Combined Authority Order 2017 and The Combined Authorities (Finance) Order 2017.

Advice given by: Shahzia Daya, Director of Legal Services

Human Resources Implications:

- 9 The funding for the staff establishment for WECA functions is provided for within the proposed Budget in line with the resourcing requirements. There are no direct human resource implications arising from the report itself.

Advice given by: Alex Holly, Head of Human Resources

Appendices & Background papers:

Appendix 1: Capital Budget Narrative 2019/20

Appendix 2: Capital Budget 2019/20

Appendix 3: Treasury Management Strategy 2019/20

Appendix 4: Investment Strategy 2019/20

West of England Combined Authority Contact:

Any person seeking background information relating to this item should seek the assistance of the contact officer for the meeting who is Ian Hird / Tim Milgate on 0117 332 1486; or by writing to West of England Combined Authority, 3 Rivergate, Temple Way, Bristol BS1 6EW; email: democratic.services@westofengland-ca.gov.uk

**WEST OF ENGLAND COMBINED AUTHORITY AND LOCAL ENTERPRISE
PARTNERSHIP CAPITAL BUDGET 2019/20**

1. Budget Context

- 1.1. The proposed West of England Combined Authority (WECA) Capital Programme is set out in Appendix 2 and includes both currently approved and proposed capital schemes.
- 1.2. The funding for the WECA Capital Programme comes from 2 main sources:
 - Investment funding provided by the Government as part of the Devolution Deal (£15m revenue and £15m capital funding pa for 30 years, totalling £900m)
 - The Transforming Cities Fund (£103m over 5 years)
- 1.3. In addition, WECA act as Accountable Body for the LEP activities, which includes significant capital investment in the region. This capital investment is therefore the responsibility of the Joint Committee, but is being presented within this report to provide context and magnitude for the regional capital investment programme, being delivered or influenced by WECA.
- 1.4. The funding for the LEP Capital Programme comes from 3 main sources:
 - Local Growth Funding (LGF) provided by the Government as West of England Growth Deal capital funding (£202m funding to be spent by 2020/21)
 - The Revolving Infrastructure Fund (£57m)
 - The Economic Development Fund (£500m)

2. WECA Capital Investment Programme 2018/19 to 2022/23

- 2.1. The proposed WECA Capital programme as set out at Appendix 2 shows both approved and proposed schemes:

- **Approved** – these schemes are fully agreed to be progressed and will be taken forwards in line with financial regulation, standing orders and the relevant assurance framework.
- **Indicative** (shown in italics in Appendix 2) – these schemes will need to be brought back to the WECA Committee for further approval before they can be progressed. The indicative approval provides a guide to officers in prioritising resources to work up schemes for further consideration.
- **Proposed** – the Wraxall Road Roundabout Scheme is considered within the Investment Fund report elsewhere on this agenda. The proposed budget assumes that approval is given for £1,488k of Investment Funding for the delivery of a Full Business Case for this scheme.

2.2. Appendix 2 is summarised in the table below, showing the profile of spend across 5 years including 2018/19:

Capital Programme	2018/19 £000	2019/20 £000	2020/21 £000	2021/22 £000	2022/23 £000
Weca					
Infrastructure	13,069	22,421	39,800	(1,300)	(15,000)
Business & Skills	5,000	0	0	0	0
Corporate Services	50	0	0	0	0
Mayoral					
Highways	18,813	17,572	17,572	17,572	17,572
Total	36,932	39,993	57,372	16,272	2,572

The bracketed figures represent net repayments back into the investment fund resulting from the revolving element of the land acquisition fund.

- 2.3. The Committee is asked to **approve** the following:
- 2.4. **£17.572M for Highways Maintenance and Integrated Transport** – in line with the proposals outlined in the Mayoral Budget for 2019/20 set out separately on this Agenda and allocated as capital grant funding to the constituent councils.
- 2.5. The Mayor is responsible for the payment of this transport related annual capital grant funding that was previously distributed by the Department for Transport incorporating highways maintenance grants, highways incentive grants and integrated transport grants. This funding will continue to be allocated to the three WoE councils as per the previous two financial years.
- 2.6. The Highways and Transport grants are currently funded through Business Rate Retention within the current WECA pilot scheme. With the new national

business rate retention system due for implementation in 2020/21, it is assumed that the £17.572m will revert back to capital grant funding.

- 2.7. The Committee is asked to **note** the approval elsewhere on the agenda of £1.488m for Full Business Case costs for Wraxall Road Roundabout Scheme.
- 2.8. The Committee is asked to confirm the following **indicative** allocations:
- 2.9. **The allocation of £17.572M for Highways and Integrated Transport Funding for 2020/21** – this is the remaining element of the four-year allocations for transport committed by the DfT as part of the devolution deal.
- 2.10. The Committee is asked to note the following **indicative** allocations which were agreed within the budget report last year or during the year at Committee:
 - **£25.4m to support the delivery of fully worked up business cases** - this funding will be specifically allocated to support the delivery of business cases from the currently prioritised schemes that have been approved for development. The actual value required will be determined following approval by the WECA of the business cases to be taken forward.
 - **£50m for the Land Acquisition Fund** – within the 5 year period shown in Appendix 2 this represents a net expenditure of £22.5m, after taking account of phasing and some repayment of the funds. This £50m Land Acquisition Fund is to support a West of England programme for the delivery of housing and infrastructure through land and property acquisition. The establishment of this fund was approved at the November WECA Committee, and is further considered in the Investment Strategy element of this report
 - **£6m for Metrowest Rail** – this notional allocation of £6m was approved by WECA in September 2018, subject to further exploration of funding solutions. This work is continuing and whilst this takes place, the £6m WECA funding remains notionally allocated.
- 2.11. **Further funding announcements** – a number of further announcements are expected from government in the next year including Housing Infrastructure Funding for which a bid is currently being prepared for submission in March 2019. For any new funding announcements in the coming year, detailed proposals will be brought forward for consideration by the WECA once confirmation of funding and any relevant criteria have been received.
- 2.12. **Capital Funding** – All capital costs will be met from Government grants, devolution investment funding or revenue contributions to capital outlay (RCCO). The capital funding period to 2022/23 includes the Government's first

5 year gateway review and further investment funding beyond 2020/21 will be subject to meeting the requirements of the gateway review.

- 2.13. **Investment Fund Revenue** – This report includes capital projects only. Revenue running costs and one-off projects which are revenue in nature, will be funded from the revenue element of the Investment Fund, and are discussed in the WECA Revenue Budget report elsewhere on this agenda.
- 2.14. **Borrowing** - no borrowing is proposed for the WECA to meet capital commitments for 2019/20 although the regulations to permit such borrowing have been confirmed as set out in the Treasury Strategy at Appendix 3.

3. Accountable Body Functions

- 3.1. The WECA acts as the Accountable Body for the West of England Local Enterprise Partnership (LEP). The capital funding streams administered by the Accountable Body include Local Growth Fund, Economic Development Fund and Revolving Infrastructure Fund.
- 3.2. The approval and administration of these funding streams is dealt with by the Joint Committee, via the One Front Door approach. However, as Accountable Body for these funds, a summary is included below to provide context and to show the estimated value of investment in the region from these sources of funding:

Forecast Spend	2018/19 £000	2019/20 £000	2020/21 £000	2021/22 £000	2022/23 £000
LGF					
Transport	16,140	27,129	7,150	0	0
FE Skills	8,737	3,300	2,700	0	0
Infrastructure	17,117	4,316	0	0	0
Innovation	28,964	21,945	11,268	0	0
RIF					
GP & RGF2	8,272	0	0	0	0
Total	79,230	56,690	21,118	0	0

- 3.3. All the projects within the LGF and RIF programmes are delivered by the constituent authorities or other bodies – but not directly delivered by WECA. As such, WECA is considered to act as agent in administering the grants, hence these projects do not appear within the WECA capital budget.
- 3.4. The profile reflects the condition of LGF funding that it be spent by 31st March 2021.

- 3.5. WECA is also the Accountable Body for the £500m Economic Development Fund, although the associated finances are administered by South Gloucestershire Council.
- 3.6. The four constituent authorities will deliver approved projects and can claim the costs of borrowing from the fund once practical completion of the project is achieved. Similarly to above, the WECA does not include the capital spend within its capital programme. The table below shows the estimated practical completions within the time frame of this report:

Forecast Practical Completions	2018/19 £000	2019/20 £000	2020/21 £000	2021/22 £000	2022/23 £000
EDF	4,970	4,277	138,946	101,287	36,963

APPENDIX 2

WECA & Mayoral Capital Budget						
	2018/19	2019/20	2020/21	2021/22	2022/23	Total (incl 18/19)
	Revised Budget	Original Budget	Phased Budget	Phased Budget	Phased Budget	Budget
	£000	£000	£000	£000	£000	£000
WECA Capital						
Infrastructure						
Economic Model & Scheme Prioritisation	285					285
Business Case Development (see breakdown below)	2,280	1,966				4,246
Real Time Information	504	55				559
Land Acquisition Fund (potentially with Rol)	10,000	15,000	15,000	7,500		47,500
Revolving Fund Income				(10,000)	(15,000)	(25,000)
Metrowest	0		6,000			6,000
Priority Infrastructure Schemes Delivery		5,400	18,800	1,200		25,400
	13,069	22,421	39,800	(1,300)	(15,000)	58,990
Business & Skills						
5G Smart Tourism	5,000					5,000
	5,000	0	0	0	0	5,000
Corporate Services						
IT	25					25
Building Alterations	25					25
	50	0	0	0	0	50
Mayoral Capital						
Highways & Transport Grants	17,572	17,572	17,572	17,572	17,572	87,860
Pothole Action Grant	1,241					1,241
	18,813	17,572	17,572	17,572	17,572	89,101
Grand Total	36,932	39,993	57,372	16,272	2,572	153,141
Business Case Development						
A37 to A362 Improvements – Somer Valley Enterprise Zone	268					268
Cribbs Patchway Cycle Links	181					181
Unlocking Lockleaze Development	505					505
Great Stoke Roundabout Capacity Improvements	297	248				545
Hicks Gate Roundabout	229	230				459
Hengrove - Housing Enabling Infrastructure	800					800
NEW APPROVAL -Wraxall Roundabout Signal Scheme FBC		1,488				1,488
	2,280	1,966	0	0	0	4,246

Funding			
Investment Fund	Grant	RCCO	Total
£000	£000	£000	£000
285			285
4,246			4,246
559			559
47,500			47,500
(25,000)			(25,000)
6,000			6,000
25,400			25,400
58,990	0	0	58,990
	5,000		5,000
0	5,000	0	5,000
		25	25
0	0	25	25
		50	50
	52,716	35,144	87,860
	1,241		1,241
0	53,957	35,144	89,101
58,990	58,957	35,194	153,141
268			268
181			181
505			505
545			545
459			459
800			800
1,488			1,488
4,246	0	0	4,246

West of England Combined Authority
Treasury Management Strategy Statement 2019/20

1. Introduction

- 1.1 Treasury management is the management of the Authority's cash flows, borrowing and investments, and the associated risks. The Authority has substantial sums of money invested and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of financial risk are therefore central to the Authority's prudent financial management.
- 1.2 Treasury risk management at the Authority is conducted within the framework of the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice 2017 Edition* (the CIPFA Code) which requires the Authority to approve a treasury management strategy before the start of each financial year. This report fulfils the Authority's legal obligation under the *Local Government Act 2003* to have regard to the CIPFA Code.
- 1.3 Investments held for service purposes or for commercial profit are considered in the Investment Strategy detailed in Appendix 4.

2. External Context

- 2.1 **Economic background:** The UK's progress negotiating its exit from the European Union, together with its future trading arrangements, will continue to be a major influence on the Authority's treasury management strategy for 2019/20.
- 2.2 UK Consumer Price Inflation (CPI) for October was up 2.4% year/year, slightly below the consensus forecast and broadly in line with the Bank of England's November Inflation Report. The most recent labour market data for October 2018 showed the unemployment rate edged up slightly to 4.1% while the

employment rate of 75.7% was the joint highest on record. The 3-month average annual growth rate for pay excluding bonuses was 3.3% as wages continue to rise steadily and provide some pull on general inflation. Adjusted for inflation, real wages grew by 1.0%, a level still likely to have little effect on consumer spending.

- 2.3 The rise in quarterly GDP growth to 0.6% in Q3 from 0.4% in the previous quarter was due to weather-related factors boosting overall household consumption and construction activity over the summer following the weather-related weakness in Q1. At 1.5%, annual GDP growth continues to remain below trend. Looking ahead, the BoE, in its November Inflation Report, expects GDP growth to average around 1.75% over the forecast horizon, providing the UK's exit from the EU is relatively smooth.
- 2.4 Following the Bank of England's decision to increase Bank Rate to 0.75% in August, no changes to monetary policy has been made since. However, the Bank expects that should the economy continue to evolve in line with its November forecast, further increases in Bank Rate will be required to return inflation to the 2% target. The Monetary Policy Committee continues to reiterate that any further increases will be at a gradual pace and limited in extent.
- 2.5 While US growth has slowed over 2018, the economy continues to perform robustly. The US Federal Reserve continued its tightening bias throughout 2018, pushing rates to the current 2%-2.25% in September. Markets continue to expect one more rate rise in December, but expectations are fading that the further hikes previously expected in 2019 will materialise as concerns over trade wars drag on economic activity.
- 2.6 **Credit outlook:** The big four UK banking groups have now divided their retail and investment banking divisions into separate legal entities under ringfencing legislation. Bank of Scotland, Barclays Bank UK, HSBC UK Bank, Lloyds Bank, National Westminster Bank, Royal Bank of Scotland and Ulster Bank are the ringfenced banks that now only conduct lower risk retail banking activities. Barclays Bank, HSBC Bank, Lloyds Bank Corporate Markets and NatWest Markets are the investment banks. Credit rating agencies have adjusted the ratings of some of these banks with the ringfenced banks generally being better rated than their non-ringfenced counterparts.
- 2.7 The Bank of England released its latest report on bank stress testing, illustrating that all entities included in the analysis were deemed to have passed the test once the levels of capital and potential mitigating actions presumed to be taken by management were factored in. The BoE did not require any bank to raise additional capital.

- 2.8 European banks are considering their approach to Brexit, with some looking to create new UK subsidiaries to ensure they can continue trading here. The credit strength of these new banks remains unknown, although the chance of parental support is assumed to be very high if ever needed. The uncertainty caused by protracted negotiations between the UK and EU is weighing on the creditworthiness of both UK and European banks with substantial operations in both jurisdictions.
- 2.9 **Interest rate forecast:** Following the increase in Bank Rate to 0.75% in August 2018, the Authority's treasury management adviser Arlingclose is forecasting two more 0.25% increases during 2019 to take official UK interest rates to 1.25%. The Bank of England's MPC has maintained expectations for slow and steady rate rises over the forecast horizon. The MPC continues to have a bias towards tighter monetary policy but is reluctant to push interest rate expectations too strongly. Arlingclose believes that MPC members consider both that ultra-low interest rates result in other economic problems, and that higher Bank Rate will be a more effective policy weapon should downside Brexit risks crystallise when rate cuts will be required.
- 2.10 The UK economic environment remains relatively soft, despite seemingly strong labour market data. Arlingclose's view is that the economy still faces a challenging outlook as it exits the European Union and Eurozone growth softens. While assumptions are that a Brexit deal is struck and some agreement reached on transition and future trading arrangements before the UK leaves the EU, the possibility of a "no deal" Brexit still hangs over economic activity (*at the time of writing*). As such, the risks to the interest rate forecast are considered firmly to the downside.
- 2.11 Gilt yields and hence long-term borrowing rates have remained at low levels but some upward movement from current levels is expected based on Arlingclose's interest rate projections, due to the strength of the US economy and the ECB's forward guidance on higher rates. 10-year and 20-year gilt yields are forecast to remain around 1.7% and 2.2% respectively over the interest rate forecast horizon, however volatility arising from both economic and political events are likely to continue to offer borrowing opportunities.
- 2.12 A more detailed economic and interest rate forecast provided by Arlingclose is attached at Appendix A.
- 2.13 For the purpose of setting the budget, it has been assumed that new investments will be made at an average rate of 1.3% for WECA balances, and 0.9% for LGF and RIF balances.

3. Local Context

- 3.1 On 31st December 2018, the Authority held £188m of investments and no borrowing. This is set out in further detail at **Appendix B**.
- 3.2 The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment.
- 3.3 The Authority is currently debt free and its capital expenditure plans do not currently imply any need to borrow over the forecast period. Investments are forecast to fall to £133m by the end of 2019/20 as capital grants are used to finance capital expenditure and reserves are used to finance the revenue budget.

4. Investment Strategy

- 4.1 The Authority holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. Since 1 April 2018, the Authority's investment balance has ranged between £123m and £210m, and similarly for 2019/20 the balances are expected to range between £120m and £198m (slightly lower due to capital grants and reserves being used to finance spend).
- 4.2 As well as holding investments in its own right, the Authority also acts as Accountable Body for the West of England Revolving Investment Fund (RIF) and Local Growth Fund (LGF), holding Government Grants until they are ready to be distributed to Local Authorities and other organisations for infrastructure works over the coming years.
- 4.3 The funds are invested in line with the WECA strategy primarily to protect the capital and in order to achieve this high level of capital security, investments are made predominantly with Central Government, Local Authorities and Banks.
- 4.4 Interest earned on RIF investments is re-invested into the Fund. LGF investment returns are earmarked to fund the corporate support and governance costs that come with performing the Accountable Body function for the Local Enterprise Partnership (LEP).
- 4.5 **Objectives:** The CIPFA Code requires the Authority to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Authority's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income. Where balances are expected to be invested for more than one year, the Authority will aim to achieve a total

return that is equal or higher than the prevailing rate of inflation, in order to maintain the spending power of the sum invested. Given the current level of CPI at 2.2% this will be difficult to achieve with fixed term deposits alone. However, the intention is to consider further longer term investments such as pooled funds, which will achieve a higher rate of return. Any temporary liquidity issues that may arise can then be dealt with by short term borrowing.

- 4.6 **Negative interest rates:** If the UK enters into a recession in 2019/20, there is a small chance that the Bank of England could set its Bank Rate at or below zero, which is likely to feed through to negative interest rates on all low risk, short-term investment options. This situation already exists in many other European countries. In this event, security will be measured as receiving the contractually agreed amount at maturity, even though this may be less than the amount originally invested.
- 4.7 **Strategy:** Given the increasing risk and very low returns from short-term unsecured bank investments, the Authority aims to further diversify into more secure and/or higher yielding asset classes during 2019/20. This is especially the case for the estimated £20m that is available for longer-term investment. A dwindling proportion of the Authority's surplus cash remains invested in short-term unsecured bank deposits and money market funds. This diversification will represent a continuation of the strategy adopted in 2018/19. The strategy of this policy is to set outer limits for treasury management operations. In the case of exceptional market uncertainty, WECA officers will operate in a more restrictive manner than the policy allows.
- 4.8 **Business models:** Under the new IFRS 9 standard, the accounting for certain investments depends on the Authority's "business model" for managing them. The Authority aims to achieve value from its internally managed treasury investments by a business model of collecting the contractual cash flows and therefore, where other criteria are also met, these investments will continue to be accounted for at amortised cost.
- 4.9 **Approved counterparties:** The Authority may invest its surplus funds with any of the counterparty types in table 1 below, subject to the cash limits (per counterparty) and the time limits shown.

Table 1: Approved investment counterparties and limits

Credit rating	Banks unsecured	Banks secured	Government	Corporates	Registered Providers
UK Govt	n/a	n/a	£ Unlimited 50 years	n/a	n/a
AAA	£10m 5 years	£15m 20 years	£10m 50 years	£10m 20 years	£5m 20 years
AA+	£10m 5 years	£15m 10 years	£15m 25 years	£5m 10 years	£5m 10 years
AA	£10m 4 years	£15m 5 years	£15m 15 years	£5m 5 years	£5m 10 years
AA-	£10m 3 years	£15m 4 years	£10m 10 years	£5m 4 years	£5m 10 years
A+	£10m 2 years	£15m 3 years	£10m 5 years	£5m 3 years	£5m 5 years
A	£10m 13 months	£10m 2 years	£10m 5 years	£5m 2 years	£5m 5 years
A-	£10m 6 months	£10m 13 months	£10m 5 years	£5m 13 months	£5m 5 years
None	£1m 6 months	n/a	£10m 25 years	£50,000 5 years	£3m 5 years
Pooled funds and real estate investment trusts		£10m per fund or trust			

This table must be read in conjunction with the notes below

- a) **Credit rating:** Investment limits are set by reference to the lowest published long-term credit rating from a selection of external rating agencies. Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used. However, investment decisions are never made solely based on credit ratings, and all other relevant factors including external advice will be taken into account.
- b) **Banks unsecured:** Accounts, deposits, certificates of deposit and senior unsecured bonds with banks and building societies, other than multilateral development banks. These investments are subject to the risk of credit loss via a bail-in should the regulator determine that the bank is failing or likely to fail. See below for arrangements relating to operational bank accounts.
- c) **Banks secured:** Covered bonds, reverse repurchase agreements and other collateralised arrangements with banks and building societies. These investments are secured on the bank's assets, which limits the potential losses

in the unlikely event of insolvency, and means that they are exempt from bail-in. Where there is no investment specific credit rating, but the collateral upon which the investment is secured has a credit rating, the higher of the collateral credit rating and the counterparty credit rating will be used to determine cash and time limits. The combined secured and unsecured investments in any one bank will not exceed the cash limit for secured investments.

- d) **Government:** Loans, bonds and bills issued or guaranteed by national governments, regional and local authorities and multilateral development banks. These investments are not subject to bail-in, and there is generally a lower risk of insolvency, although they are not zero risk. Investments with the UK Central Government may be made in unlimited amounts for up to 50 years.
- e) **Corporates:** Loans, bonds and commercial paper issued by companies other than banks and registered providers. These investments are not subject to bail-in, but are exposed to the risk of the company going insolvent. Loans to unrated companies will only be made either following an external credit assessment or to a maximum of £50,000 per company as part of a diversified pool in order to spread the risk widely.
- f) **Registered providers:** Loans and bonds issued by, guaranteed by or secured on the assets of registered providers of social housing and registered social landlords, formerly known as housing associations. These bodies are tightly regulated by the Regulator of Social Housing (in England), the Scottish Housing Regulator, the Welsh Government and the Department for Communities (in Northern Ireland). As providers of public services, they retain the likelihood of receiving government support if needed.
- g) **Pooled funds:** Shares or units in diversified investment vehicles consisting of the any of the above investment types, plus equity shares and property. These funds have the advantage of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a fee. Short-term Money Market Funds that offer same-day liquidity and very low or no volatility will be used as an alternative to instant access bank accounts, while pooled funds whose value changes with market prices and/or have a notice period will be used for longer investment periods.

The Authority may consider further investment in Pooled Funds during 2019/20 with a view to providing further diversification and the potential for earning a higher investment yield on long-term investment balances. Cash that is not required to meet any short or medium-term liquidity need can be invested for the longer term with a greater emphasis on achieving returns that will support spending on local WECA services.

Bond, equity and property funds offer enhanced returns over the longer term, but are more volatile in the short term. These allow the Authority to diversify

into asset classes other than cash without the need to own and manage the underlying investments. Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Authority's investment objectives will be monitored regularly.

- h) **Real estate investment trusts:** Shares in companies that invest mainly in real estate and pay the majority of their rental income to investors in a similar manner to pooled property funds. As with property funds, REITs offer enhanced returns over the longer term, but are more volatile especially as the share price reflects changing demand for the shares as well as changes in the value of the underlying properties.
- i) **Operational bank accounts:** The Authority may incur operational exposures, for example through current accounts, collection accounts and merchant acquiring services, to any UK bank with credit ratings no lower than BBB- and with assets greater than £25 billion. These are not classed as investments, but are still subject to the risk of a bank bail-in, and balances will therefore be kept below £100,000 per bank. The Bank of England has stated that in the event of failure, banks with assets greater than £25 billion are more likely to be bailed-in than made insolvent, increasing the chance of the Authority maintaining operational continuity.
- j) **Risk assessment and credit ratings:** Credit ratings are obtained and monitored by the Authority's treasury advisers, who will notify changes in ratings as they occur. Where an entity has its credit rating downgraded so that it fails to meet the approved investment criteria then:
- no new investments will be made,
 - any existing investments that can be recalled or sold at no cost will be, and
 - full consideration will be given to the recall or sale of all other existing investments with the affected counterparty.

Where a credit rating agency announces that a credit rating is on review for possible downgrade (also known as "rating watch negative" or "credit watch negative") so that it may fall below the approved rating criteria, then only investments that can be withdrawn on the next working day will be made with that organisation until the outcome of the review is announced. This policy will not apply to negative outlooks, which indicate a long-term direction of travel rather than an imminent change of rating.

- k) **Other information on the security of investments:** The Authority understands that credit ratings are good, but not perfect, predictors of investment default. Full regard will therefore be given to other available information on the credit quality of the organisations in which it invests,

including credit default swap prices, financial statements, information on potential government support, reports in the quality financial press and analysis and advice from the Authority's treasury management adviser. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may otherwise meet the above criteria.

When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008 and 2011, this is not generally reflected in credit ratings, but can be seen in other market measures. In these circumstances, the Authority will restrict its investments to those organisations of higher credit quality and reduce the maximum duration of its investments to maintain the required level of security. The extent of these restrictions will be in line with prevailing financial market conditions. If these restrictions mean that insufficient commercial organisations of high credit quality are available to invest the Authority's cash balances, then the surplus will be deposited with the UK Government via the Debt Management Office or invested in government treasury bills for example, or with other local authorities. This will cause a reduction in the level of investment income earned, but will protect the principal sum invested.

- l) **Investment limits:** The Authority's revenue reserves available to cover investment losses are forecast to be £0.5 million on 31st March 2019. This low level of reserves means that in the event of a single default loss, WECA will have limited resources to cover such a loss. The revenue budget report elsewhere on this agenda recommends a small increase in general reserves. With this in mind, the maximum that will be lent to any one organisation (other than the UK Government) will be £10 million. A group of banks under the same ownership will be treated as a single organisation for limit purposes. Limits will also be placed on fund managers, investments in brokers' nominee accounts, foreign countries and industry sectors as below. Investments in pooled funds and multilateral development banks do not count against the limit for any single foreign country, since the risk is diversified over many countries.

Table 4: Investment limits

	Cash limit
Any single organisation, except the UK Central Government	£10m each
UK Central Government	unlimited
Any group of organisations under the same ownership	£10m per group
Any group of pooled funds under the same management	£10m per manager
Negotiable instruments held in a broker's nominee account	£10m per broker
Foreign countries	£15m per country (AAA sovereign rating) £10m per country (AA+ sovereign rating)
Registered providers and registered social landlords	£50m in total
Unsecured investments with building societies	£20m in total
Loans to unrated corporates	£20m in total
Money market funds	£100m in total
Real estate investment trusts	£50m in total

m) **Liquidity management:** The Authority uses cash flow forecasting to determine the maximum period for which funds may prudently be committed. The forecast is compiled on a prudent basis to minimise the risk of the Authority being forced to borrow on unfavourable terms to meet its financial commitments. Limits on long-term investments are set by reference to the Authority's medium-term financial plan and cash flow forecast. The intention is to invest a limited amount of funds on a longer term basis to secure higher returns, and based on cashflow forecasts. This may result in a temporary liquidity issue, which will be dealt with via short term borrowing – as a proactive treasury tool.

5. **Borrowing Strategy**

5.1 The Authority currently holds no borrowing. The balance sheet forecast shows that the Authority does not expect to need to borrow in 2019/20.

5.2 **Objectives:** The Authority's chief objective when borrowing money is to strike an appropriately low risk balance between securing low interest costs and achieving certainty of those costs over the period for which funds are required. The flexibility to renegotiate loans should the Authority's long-term plans change is a secondary objective.

5.3 **Strategy:** The Authority does not currently have any underlying need to borrow long-term to fund capital expenditure. WECA holds no long-term loans and no long-term borrowing is anticipated during 2019/20. Therefore, a debt-free strategy will be maintained until such time as the Authority determines that its capital strategy and prioritised programme of investment requires consideration of any borrowing decision.

5.4 As part of its approach to liquidity management, the Authority may borrow short-term loans to cover any unplanned cash flow shortages as they arise. Rather than always keeping cash on instant access for unplanned cash flows (where security and liquidity will mean yields will be low) the Authority will retain the option of short-term borrowing at current low rates to enable it to explore increasing investments in longer-term and more diversified assets. The Authority will test access to borrowing occasionally even where this is not required to ensure liquidity is available.

5.5 **Sources of borrowing:** The approved sources of short-term borrowing are:

- Public Works Loan Board (PWLB) and any successor body
- any institution approved for investments (see below)
- any other bank or building society authorised to operate in the UK
- any other UK public sector body
- UK public and private sector pension funds (except Avon Pension Fund)
- capital market bond investors
- UK Municipal Bonds Agency plc and other special purpose companies created to enable local authority bond issues

5.6 **Other sources of debt finance:** In addition, capital finance may be raised by the following methods that are not borrowing, but may be classed as other debt liabilities:

- leasing
- hire purchase
- Private Finance Initiative
- sale and leaseback

5.7 **Short-term and variable rate loans:** These loans leave the Authority exposed to the risk of short-term interest rate rises and are therefore subject to the interest rate exposure limits in the treasury management indicators below.

6. Treasury Management Indicators

6.1 The Authority measures and manages its exposures to treasury management risks using the following indicators.

6.2 **Security:** The Authority has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating of its investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment.

Credit risk indicator	Target
Minimum portfolio average credit rating	A-

6.3 **Liquidity:** The Authority has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount it can borrow each quarter without giving prior notice.

Liquidity risk indicator	Target
Total sum borrowed in past 3 months without prior notice	£30m

6.4 **Interest rate exposures:** This indicator is set to control the Authority's exposure to interest rate risk. The upper limits on the one-year revenue impact of a 1% rise or fall in interest rates will be:

Interest rate risk indicator	Limit
Upper limit on one-year revenue impact of a 1% <u>fall</u> in interest rates	£570k

The impact of a change in interest rates is calculated on the assumption that maturing loans and investments will be replaced at current rates.

6.5 **Principal sums invested for periods longer than a year:** The purpose of this indicator is to control the Authority's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the long-term principal sum invested to final maturities beyond the period end will be:

Price risk indicator	2019/20	2020/21	2021/22
Limit on principal invested beyond year end	£100m	£75m	£50m

7. Related Matters

The CIPFA Code requires the Authority to include the following in its treasury management strategy.

- 7.1 **Financial Derivatives:** In the absence of any explicit legal power to do so, the Authority will not use standalone financial derivatives (such as swaps, forwards, futures and options). Derivatives embedded into loans and investments, including pooled funds and forward starting transactions, may be used, and the risks that they present will be managed in line with the overall treasury risk management strategy.
- 7.2 **Markets in Financial Instruments Directive (MiFID II):** As a result of the directive, Local Authorities will be treated as retail clients, but can opt up to professional client status, providing that they meet certain criteria which includes having an investment balance of at least £10m and the persons authorised to make investment decisions on behalf of WECA having at least a year's relevant professional experience. In addition, the regulated financial services firms to whom this directive applies must assess that these persons have the expertise, experience and knowledge to make investment decisions and understand the risks involved.

The Authority has opted up to professional client status with its providers of financial services, including advisers, banks, brokers and fund managers, allowing it access to a greater range of services but without the greater regulatory protections afforded to individuals and small companies. Given the size and range of the Authority's treasury management activities, the Chief Financial Officer believes this to be the most appropriate status.

8. Financial Implications

- 8.1 The budget for WECA investment income in 2019/20 is £0.82 million, based on an average investment portfolio of £71 million at an interest rate of 1.3% and making an allowance for impairment as required. In addition, the budget for the LEP investment income in 2019/20 is £0.5 million, based on an average investment of £60 million at an interest rate of 0.9% and making an allowance for impairment. The differing levels of interest expected to be achieved reflect the ability to invest the funds for longer terms and hence achieve a higher return. Longer term investment of LEP funds is limited as LGF grant will all be spent within the next 2 years. If actual levels of investments, or actual

interest rates, differ from those forecast, performance against budget will be correspondingly different.

9. Other Options Considered

- 9.1 The CIPFA Code does not prescribe any particular treasury management strategy for local authorities to adopt. The Chief Financial Officer, having consulted the West of England Mayor and Chief Executive, believes that the above strategy represents an appropriate balance between risk management and cost effectiveness. Some alternative strategies, with their financial and risk management implications, are listed below.

Alternative	Impact on income and expenditure	Impact on risk management
Invest in a narrower range of counterparties and/or for shorter times	Interest income will be lower	Lower chance of losses from credit related defaults, but any such losses may be greater
Invest in a wider range of counterparties and/or for longer times	Interest income will be higher	Increased risk of losses from credit related defaults, but any such losses may be smaller

Appendix A – Arlingclose Economic & Interest Rate Forecast December 2018

Underlying assumptions:

- Our central interest rate forecasts are predicated on there being a transitional period following the UK's official exit from the EU.
- The MPC has a bias towards tighter monetary policy but is reluctant to push interest rate expectations too strongly. We believe that MPC members consider that: 1) tight labour markets will prompt inflationary pressure in the future, 2) ultra-low interest rates result in other economic problems, and 3) higher Bank Rate will be a more effective policy weapon if downside risks to growth crystallise.
- Both our projected outlook and the increase in the magnitude of political and economic risks facing the UK economy means we maintain the significant downside risks to our forecasts, despite the potential for slightly stronger growth next year as business investment rebounds should the EU Withdrawal Agreement be approved. The potential for severe economic outcomes has increased following the poor reception of the Withdrawal Agreement by MPs. We expect the Bank of England to hold at or reduce interest rates from current levels if Brexit risks materialise.
- The UK economic environment is relatively soft, despite seemingly strong labour market data. GDP growth recovered somewhat in the middle quarters of 2018, but more recent data suggests the economy slowed markedly in Q4. Our view is that the UK economy still faces a challenging outlook as the country exits the European Union and Eurozone economic growth softens.
- Cost pressures are easing but inflation is forecast to remain above the Bank's 2% target through most of the forecast period. Lower oil prices have reduced inflationary pressure, but the tight labour market and decline in the value of sterling means inflation may remain above target for longer than expected.
- Global economic growth is slowing. Despite slower growth, the European Central Bank is conditioning markets for the end of QE, the timing of the first rate hike (2019) and their path thereafter. More recent US data has placed pressure on the Federal Reserve to reduce the pace of monetary tightening – previous hikes and heightened expectations will, however, slow economic growth.
- Central bank actions and geopolitical risks have and will continue to produce significant volatility in financial markets, including bond markets.

Forecast:

- The MPC has maintained expectations of a slow rise in interest rates over the forecast horizon, but recent events around Brexit have dampened interest rate expectations. Our central case is for Bank Rate to rise twice in 2019, after the UK exits the EU. The risks are weighted to the downside.

- Gilt yields have remained at low levels. We expect some upward movement from current levels based on our central case that the UK will enter a transitional period following its EU exit in March 2019. However, our projected weak economic outlook and volatility arising from both economic and political events will continue to offer borrowing opportunities.

	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Average
Official Bank Rate														
Upside risk	0.00	0.00	0.00	0.00	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.17
Arlingclose Central Case	0.75	0.75	1.00	1.00	1.25	1.25	1.25	1.25	1.25	1.25	1.25	1.25	1.25	1.13
Downside risk	0.00	-0.50	-0.75	-0.75	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-0.85
3-mth money market rate														
Upside risk	0.10	0.10	0.10	0.10	0.15	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.17
Arlingclose Central Case	0.90	0.95	1.10	1.30	1.40	1.40	1.40	1.35	1.35	1.35	1.35	1.35	1.35	1.27
Downside risk	-0.20	-0.45	-0.60	-0.80	-0.90	-0.90	-0.90	-0.85	-0.85	-0.85	-0.85	-0.85	-0.85	-0.76
1-yr money market rate														
Upside risk	0.20	0.30	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.33
Arlingclose Central Case	1.15	1.25	1.35	1.50	1.70	1.60	1.50	1.40	1.35	1.35	1.35	1.35	1.35	1.40
Downside risk	-0.35	-0.50	-0.60	-0.80	-0.90	-0.90	-0.90	-0.85	-0.85	-0.85	-0.85	-0.85	-0.85	-0.77
5-yr gilt yield														
Upside risk	0.25	0.30	0.30	0.35	0.35	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.37
Arlingclose Central Case	1.15	1.25	1.35	1.50	1.50	1.40	1.35	1.35	1.30	1.30	1.30	1.30	1.30	1.33
Downside risk	-0.50	-0.60	-0.65	-0.80	-0.80	-0.70	-0.65	-0.65	-0.65	-0.65	-0.65	-0.65	-0.65	-0.66
10-yr gilt yield														
Upside risk	0.25	0.30	0.30	0.35	0.35	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.37
Arlingclose Central Case	1.50	1.65	1.70	1.80	1.80	1.75	1.75	1.70	1.70	1.70	1.70	1.70	1.70	1.70
Downside risk	-0.55	-0.70	-0.70	-0.80	-0.80	-0.75	-0.75	-0.70	-0.70	-0.70	-0.70	-0.70	-0.70	-0.71
20-yr gilt yield														
Upside risk	0.25	0.30	0.30	0.35	0.35	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.37
Arlingclose Central Case	2.00	2.10	2.20	2.20	2.20	2.20	2.20	2.20	2.20	2.20	2.20	2.20	2.20	2.18
Downside risk	-0.60	-0.70	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.73
50-yr gilt yield														
Upside risk	0.25	0.30	0.30	0.35	0.35	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.37
Arlingclose Central Case	1.90	1.95	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00	1.99
Downside risk	-0.60	-0.70	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.73

PWLB Certainty Rate (Maturity Loans) = Gilt yield + 0.80%

PWLB Infrastructure Rate (Maturity Loans) = Gilt yield + 0.60%

Appendix B - Existing Investment & Debt Portfolio Position

	31 Dec 2018 Actual Portfolio £m	31 Dec 2018 Average Rate %
External borrowing:	0	0
Other long-term liabilities:	0	0
Total gross external debt	0	0
Treasury investments:		
Banks & building societies (unsecured)	30	0.85
Covered bonds & repo (secured)	0	0
Government (incl. local authorities)	124	0.93
Corporate bonds and loans	0	0
Money Market Funds	24	0.74
Other pooled funds (CCLA Property Fund)	10	4.05
Real estate investment trusts	0	0
Total treasury investments	188	0.90
Net debt	0	0

**WEST OF ENGLAND COMBINED AUTHORITY INVESTMENT STRATEGY
2019/20**

1. Introduction

- 1.1. The Authority may invest its money for three broad purposes:
- because it has surplus cash as a result of its day-to-day activities, for example when income is received in advance of expenditure (known as **treasury management investments**),
 - to support local public services by lending to or buying shares in other organisations (**service investments**), and
 - to earn investment income (known as **commercial investments** where this is the main purpose).
- 1.2. This investment strategy is a new report for 2019/20, meeting the requirements of statutory guidance issued by the government in January 2018, and focuses on the second and third of these categories.

2. Treasury Management Investments

- 2.1. The Authority typically receives its income in cash (e.g. from grants) before it pays for its expenditure in cash (e.g. through payroll and invoices). It also holds reserves for future expenditure. These activities lead to a cash surplus which is invested in accordance with guidance from the Chartered Institute of Public Finance and Accountancy. The balance of treasury management investments is expected to fluctuate between £120m and £198m during the 2019/20 financial year.
- 2.2. The contribution that these investments make to the objectives of the Authority is to support effective treasury management activities.
- 2.3. Full details of the Authority's policies and its plan for 2019/20 for treasury management investments are covered in Appendix 3, the Treasury Management Strategy.

3. Service Investments: Loans

- 3.1. The WECA may lend money to the constituent authorities to support local public services and stimulate local economic growth. In particular, the WECA Committee recently approved a £50M Land Acquisition Fund to support a West of England programme for the delivery of housing and infrastructure through land and property acquisition. The Fund is intended to enable WECA and the constituent authorities to purchase sites directly, lead on masterplanning and to facilitate and in some instances, control the delivery of infrastructure and housing. It is not necessarily intended to make a financial return as the funding is recyclable so that the Fund can continue to operate on a revolving basis. The use of Investment funding to accelerate housing delivery shows commitment and demonstrates to Government that the WECA has a robust governance and investment framework in place into which Housing Deal funding could be channelled. The details of the scheme are being worked up and will be presented to the Joint Committee (as the scheme includes North Somerset along with the three WECA Authorities). Legal advice on State Aid has been commissioned.
- 3.2. The main risk when making service loans is that the borrower will be unable to repay the principal lent and/or the interest due. In order to limit this risk, and ensure that total exposure to service loans remains proportionate to the size of the Authority, upper limits on the outstanding loans to each category of borrower have been set as follows:

Table 1: Loans for service purposes in £ millions

Category of borrower	2019/20
	Approved Limit
WECA Constituent Authorities	50
TOTAL	50

- 3.3. Accounting standards require the Authority to set aside loss allowance for loans, reflecting the likelihood of non-payment. If loans are made, the figures for loans in the Authority's statement of accounts will be shown net of this loss allowance. However, the Authority will make every reasonable effort to collect the full sum lent and will have appropriate credit control arrangements in place to recover overdue repayments. To date no such loans have been made.
- 3.4. The Authority will assess the risk of loss before entering into and whilst holding service loans in the following way. The criteria for agreeing such loans is

currently being developed, but at present any loans are restricted to the 3 constituent authorities.

4. Service Investments: Shares

- 4.1. The Council has not invested in and has no current intention of investing in shares to support local public services and stimulate local economic growth. The only exception to this may be related to the land acquisition fund discussed above – there may be a benefit in investing in a Local Authority Housing Company to best achieve the objectives of the fund. Should this be the case, a report will be brought before the Committee requesting approval to purchase shares in the LA company.

5. Commercial Investments: Property

- 5.1. For this purpose, commercial property investments are defined as property held primarily or mainly to generate a profit. The WECA does not intend to invest in property with the sole intention of making a profit. However, as part of its service investment intentions as explained above, such investments may result in both the required service objective, and a return on investment eg the Land Acquisition Fund.
- 5.2. In a similar way, the WECA will be bidding for Housing Infrastructure Funding, some of which may be used for investments that provide a return in addition to the service objective.

6. Capacity, Skills and Culture

- 6.1. Elected members and statutory officers: any future proposals regarding service investments will be considered by the WECA Committee before approval to proceed is given, taking into account the individual proposal, an assessment of risk and total risk exposure.

7. Investment Indicators

- 7.1. The Authority is required to set quantitative indicators to allow elected members and the public to assess the Authority's total risk exposure as a result of its investment decisions. As WECA has not yet, and may not make such investments, there are no indicators included at this stage. As the details around the Land Acquisition Fund are confirmed, such indicators will be reported to Committee should they be required.

