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Agenda Item No. 9.3

Board Meeting

Date	17 February 2017
Report title	2017/18 WMCA Treasury Management Strategy
Cabinet Member Portfolio Lead	Councillor Izzi Seccombe – Finance & Investments
Accountable Chief Executive	Jan Britton Chief Operating Officer Email Jan_Britton@sandwell.gov.uk Tel 0121 569 3501
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Report to be/has been considered by	Management Board - 2 February 2017 Programme Board - 3 February 2017

The Combined Authority Board is recommended to:

Approve:

1. The Minimum Revenue Provision (MRP) Statement set out in Section 11.
2. Delegate authority to the West Midlands Combined Authority Section 151 Officer to undertake borrowing in accordance with this Strategy.
3. The West Midlands Combined Authority Treasury Management and Investment Strategy for 2017/18 as set out in this report.

Note and Endorse:

1. The West Midlands Combined Authority Treasury Management and Investment Strategy for 2017/18.
2. The prudential and treasury management indicators and limits described in section 13 and as detailed in Appendix 3.

1.0 Purpose

1.1 The report outlines the West Midlands Combined Authority's (WMCA) Treasury Management and Investment Strategy for 2017/18.

1.2 It sets out the approved prudential and treasury management indicators for the period to 31 March 2020 and sets out the expected treasury operations for this period.

2.0 Impact on delivery of the Strategic Transport Plan

2.1 The Treasury Management Strategy details the expected activities of the treasury function in the forthcoming year 2017/18. The publication of the strategy is a statutory requirement.

3.0 Main Principles of Treasury Management

3.1 The overall aim of the Treasury Management Policy is to manage the Authority's cash resources so that sufficient money is available to deliver its services whilst at the same time minimising the costs of debt and maximising investment returns taking into account an acceptable level of risk.

3.2 No treasury management activity is without risk. The successful identification, monitoring and control of risk are integral elements to treasury management activities and include credit and counterparty risk, liquidity / market or interest rate risk, refinancing risk, and legal & regulatory risk. In addition future stability and predictability are also important considerations to be assessed.

In summary the WMCA Policy objectives are:-

3.2.1 Borrowing:

- To maintain adequate liquidity.
- To manage revenue costs at an appropriate level of risk.
- To undertake funding in any year at the best rates available, taking into account existing commitments and future needs..
- To manage the total debt maturity profile to ensure a fairly even spread of future repayments.
- To review actively, opportunities to redeem (i.e. repay early) and reschedule debt (i.e. replace one debt with another) as interest rates change, to reduce revenue costs

3.2.2 Investment:

The fundamental principles governing the WMCA's investment criteria are the security of its investments, taking into account investment return. The WMCA will ensure:

- Maintenance of capital security..
- Maintenance of adequate liquidity.

- Maximum revenue benefit subject to appropriate risk..

3.3 As in all Local Authorities the Authority is required to abide by the Prudential Code and The Chartered Institute of Public Finance and Accountancy's Code of Practice for Treasury Management (The CIPFA TM Code of Practice (revised 2012)). The guidance arising from these codes has been incorporated within this report

3.4 All treasury activity will comply with relevant statute, guidance and accounting standards.

4.0 Treasury Management

4.1 The guidance to the CIPFA TM Code of Practice (2012) and the Prudential Code (revised November 2011) highlighted the need to reinforce organisational reporting, clarity and segregation of responsibilities as well as counterparty credit ratings.

4.2 The key implications were as follows;

Minimum Reporting Requirements

The WMCA will receive a minimum of three reports throughout the year as follows;

- An annual report on the strategy and plan to be pursued in the coming year.
- A mid-year review..
- An annual report on the performance of the treasury management activities

4.3 In addition to the above, the Prudential Indicators are currently included within the regular Financial Monitoring Reports to Committee and these will continue to be included and reported during the year.

Scrutiny and Approval

4.4 The WMCA will approve any changes required to the Treasury Management Strategy due to changes resulting from regulatory, economic, market or other factors affecting its treasury management activities, following the approval by a responsible member body. This is currently the Section 151 Officer to WMCA in conjunction with the WMCA Head of Finance and other WMCA officers responsible for Treasury Management activities (referred to as Treasury Management Group).

Officer and Member Training

4.5 The Section 151 Officer to WMCA must ensure that appropriate training is available so that those responsible for treasury management can effectively discharge their duties. The needs of the Authority's treasury management staff for training in investment management are assessed regularly as part of the staff appraisal process, and additionally when the responsibilities of individual members of staff change. Staff regularly attend training courses, seminars and conferences provided by Arlingclose and CIPFA. Relevant staff are also encouraged to study professional qualifications from CIPFA, the Association of Corporate Treasurers and other appropriate organisations.

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5.0 Treasury Management Strategy

5.1 The Authority's treasury activities are regulated by statutory requirements. The CIPFA Code of Practice for Treasury Management in Public Services (the TM Code of Practice), and the Prudential Code require local authorities to determine the Treasury Management Strategy Statement (TMSS) and the Prudential Indicators (PI's) on an annual basis. The TMSS also includes the Annual Investment Strategy (AIS) that is a requirement of the Department for Communities Local Government (CLG's) Investment Guidance.

5.2 WMCA are supported by professional advisors Arlingclose limited in order to ensure that up to date market advice and information on the most appropriate investment / borrowing options is obtained. This arrangement is jointly funded between WMCA and Coventry City Council who also use Arlingclose.

6.0 External Climate

6.1 The major external influence on the Authority's treasury management strategy for 2017/18 will be the UK's progress in negotiating a smooth exit from the European Union. Financial markets, after incorrectly predicting the result of the referendum outcome, have since been weighed down by uncertainty over whether leaving the Union also means leaving the single market. Negotiations are expected to start once the UK formally triggers exit in early 2017 and last for at least two years. Uncertainty over future economic prospects will therefore remain throughout 2017/18.

6.2 The fall and continuing weakness in sterling and the near doubling in the price of oil in 2016 have combined to drive inflation expectations higher. The Bank of England is forecasting that Consumer Price Inflation will breach its 2% target in 2017, the first time since late 2013, but the Bank is expected to look through inflation overshoots over the course of 2017 when setting interest rates so as to avoid adversely affecting economic growth.

6.3 Looking overseas, with the US economy and its labour market showing steady improvement, the Federal Reserve increased interest rates during December 2016. The Eurozone meanwhile has continued to struggle with very low inflation and lack of momentum in growth.

6.4 Credit outlook: Markets have expressed concern over the financial viability of a number of European banks recently. Sluggish economies and continuing fines for pre-crisis behaviour have weighed on bank profits, and any future slowdown will exacerbate concerns in this regard.

6.5 Bail-in legislation, which ensures that large investors including local authorities will rescue failing banks instead of taxpayers in the future, has now been fully implemented in the European Union, Switzerland and USA, while Australia and Canada are progressing with their own plans. The credit risk associated with making unsecured bank deposits has therefore increased relative to the risk of other

investment options available to the Authority; returns from cash deposits however continue to fall.

7.0 Internal Climate

7.1 As at 31st March 2016, the WMCA had £163m of borrowing (excluding inherited debt administered by Dudley MBC) and £28.15m of investments.

7.2 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. The WMCA's strategy will be to maintain borrowing below the underlying levels by minimising cash investments at the level needed to provide sufficient liquidity; known as internal borrowing.

7.3 The Authority is able to borrow funds in excess of the current level of its CFR up to the projected level. The Authority is likely to only borrow in advance of need if it is felt that the benefits of borrowing at interest rates now compared to where they are expected to be in the future, outweighs the current cost and risks associated with investing the proceeds until the borrowing was actually required.

7.4 The forecasted movement in the CFR is one of the Prudential Indicators (PI's). and is covered in Appendix 2 paragraph 4.5.

8.0 Interest Rates

8.1 At the start of 2016/17 the base rate stood at 0.50%. On 4th August 2016, however and following the unexpected result of the EU referendum, the Bank of England base rate was reduced from 0.50% to 0.25%; the first change to the rate since 2009.

8.2 This change was against the expectation some months previous of an increase in rates towards the latter part of 2016. The Authority's treasury adviser Arlingclose's central case currently is for UK Bank Rate to remain at 0.25% during 2017/18.

8.3 The Bank of England has, however, highlighted that excessive levels of inflation will not be tolerated for sustained periods. Given this view and the current inflation outlook, further falls in the Bank Rate look less likely.

8.4 Negative Bank Rates, although a low probability, cannot be entirely ruled out in the medium term, particularly if the UK enters recession as a result of concerns over leaving the European Union.

8.5 Longer term borrowing rates are currently relatively low. Rates such as those obtainable from the PWLB are set in relation to the Gilt yield which is forecast to decline when the government triggers Article 50. The Bank of England has defended quantitative easing as a monetary policy tool and further quantitative easing in support of the UK economy in 2017/18 remains a distinct possibility, to keep long-term interest rates low.

TABLE 1 - PWLB RATES AS AT 20th JANUARY 2017

Term (Years)	Annual Interest Rate %	
	Maturity Loan	Annuity Loan
1	1.11	-
1-2	1.17 - 1.23	1.14
2-5	1.30 - 1.72	1.17 - 1.34
5-10	1.80 - 2.47	1.38 - 1.77
10-20	2.52 - 3.05	1.82 - 2.55
20-30	3.06 - 3.10	2.58 - 2.95
30-40	2.91 - 3.06	2.96 - 3.09
40-50	2.86 - 2.90	3.07 - 3.10

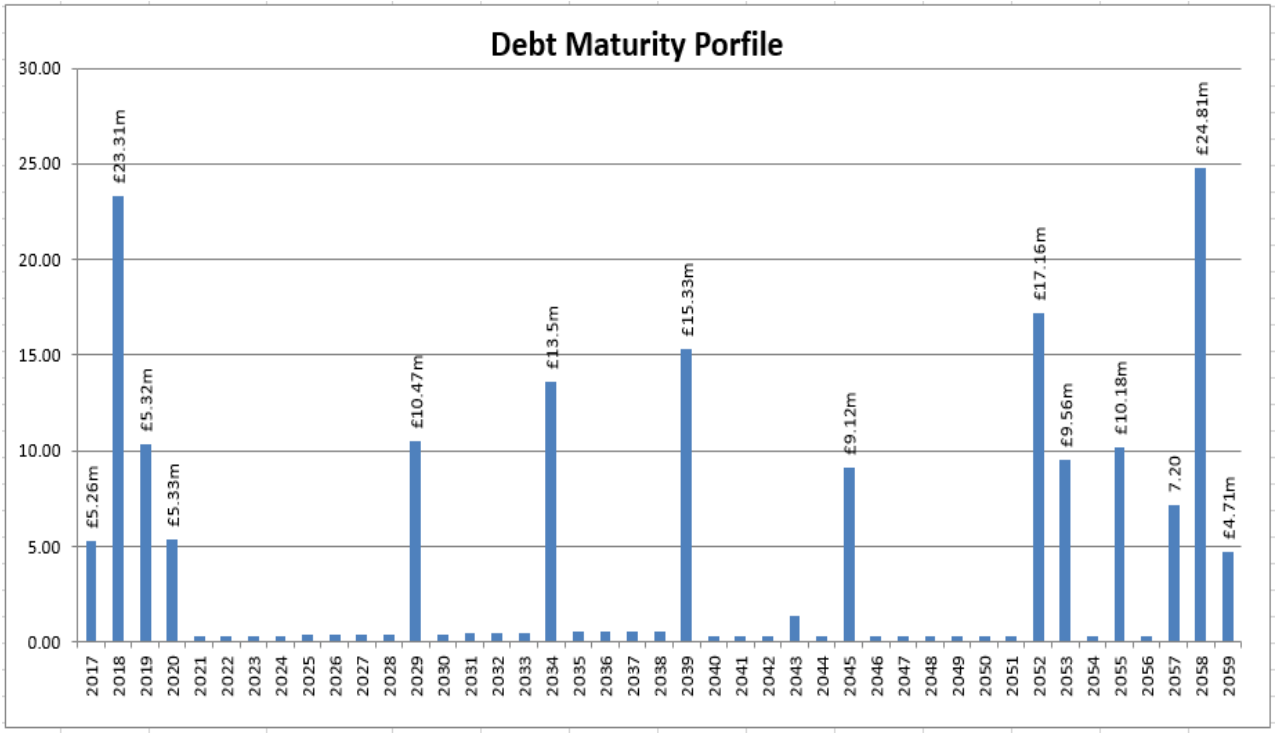
8.6 Based on current estimated levels of Capital Expenditure it is likely that up to £367m of project related borrowing may be required between 2017/18 and 2019/20 to fund the Transport Delivery Programme and WMCA Investment Programme.

8.7 The current debt position inherited from WMITA as at 20th January 2017, (excluding debt administered by Dudley MBC) is £158m. This is made up of a number of loans, details of which are shown in Table 2, with the maturity profile highlighted in the corresponding graph.

Table 2 - Borrowing as at 20 January 2017

Institution	Loan Type	Loan Value (£)	Loan Start Date	Loan Maturity Date	Interest Rate (%)	Annual Interest Charge (£)
PWLB	Maturity	5,000,000	21 Dec 1995	21 Dec 2017	7.875	393,750
PWLB	Maturity	1,067,916	20 Sep 1993	30 Apr 2018	7.875	84,098
PWLB	Maturity	21,934,712	11 Jul 1996	11 Jul 2018	8.375	1,837,032
PWLB	Maturity	5,000,000	21 Dec 1995	21 Dec 2019	7.875	393,750
PWLB	Maturity	5,000,000	21 Dec 1995	21 Dec 2020	7.875	393,750
PWLB	Maturity	10,000,000	15 Jul 2029	15 Jul 2029	3.910	391,000
PWLB	Maturity	13,000,000	16 Jun 2004	21 Jun 2034	4.950	643,500
PWLB	Maturity	5,000,000	23 Dec 2009	23 Jun 2039	4.340	217,000
PWLB	Annuity	9,631,768	15 Jul 2014	15 Jul 2039	3.870	379,966
PWLB	Maturity	1,067,916	21 Sep 1993	30 Apr 2043	7.875	84,098
PWLB	Maturity	9,000,000	02 May 2006	06 Sep 2045	4.450	400,500
PWLB	Maturity	7,000,000	02 Oct 2006	06 Mar 2052	4.100	287,000
PWLB	Maturity	4,000,000	06 Nov 2006	30 Apr 2052	4.050	162,000
PWLB	Maturity	6,000,000	23 May 2007	22 Nov 2052	4.600	276,000
PWLB	Maturity	4,800,000	06 Nov 2006	30 Apr 2053	4.050	194,400
PWLB	Maturity	4,583,380	23 May 2007	22 May 2053	4.600	210,835
PWLB	Maturity	7,000,000	22 May 1997	22 May 2057	7.375	516,250
PWLB	Maturity	4,300,000	06 Mar 1998	06 Mar 2058	6.000	258,000
PWLB	Maturity	4,300,000	06 Mar 1998	06 Mar 2058	6.125	263,375
PWLB	Maturity	16,000,000	30 Apr 1998	30 Apr 2058	5.625	900,000
PWLB	Annuity	4,325,034	23 Dec 2009	23 Dec 2059	4.340	188,764
Barclays	LOBO	10,000,000	23 Jun 2005	23 Jun 2055	4.030	401,896
Totals		**158,010,726**			5.644	**8,876,964**

8.8 The average rate of interest is 5.64% reflecting the prevailing fixed interest at the time the borrowing was taken out.



8.9 The PWLB allows authorities to repay loans before maturity and either pay a premium or receive a discount according to a set formula based on current interest rates. Other lenders may also be prepared to negotiate premature redemption terms. The Authority may take advantage of this and replace some loans with new loans, or repay loans without replacement, where this is expected to lead to an overall cost saving or a reduction in risk. In the current climate, however, the premium for early redemption is likely to make this too expensive to undertake.

8.10 The Authority has previously raised the majority of its long-term borrowing from he PWLB but it continues to investigate other sources of finance, such as local authority loans, the European Investment Bank and bank loans that may be available at more favourable rates. The main borrowing sources likely to be used by the WMCA are:

- The Public Works Loans Board (PWLB) and its successor body which is in effect, the government. Although loans may be obtained at variable rates of interest they are normally at fixed rates.

- Money Market - these are loans obtained from financial institutions, such as banks. These have generally been less competitive than PWLB loans.

- Other Local Authorities – these are an important source of short term borrowing.

- European Investment Bank (EIB) – discussions with EIB are taking place regarding a major loan facility for the WMCA. This is likely to be significantly cheaper than PWLB.

- UK Municipal Bonds Agency plc, which was established in 2014 by the Local Government Association as an alternative to the PWLB. It plans to issue bonds on the capital markets and lend the proceeds to local authorities. This will be a more complicated source of finance than the PWLB for two reasons: borrowing authorities will be required to provide bond investors with a joint and several guarantee to refund their investment in the event that the agency is unable to for any reason; and there will be a lead time of several months between committing to borrow and knowing the interest rate payable.

- In conjunction with advice from our treasury advisors, Arlingclose Ltd, the Authority will keep under review additional borrowing sources.

  - Commercial banks

  - Capital markets (stock issues, commercial paper and bills)

  - Structured finance

  - Leasing

9.0 Capital Expenditure Estimates

9.1 The forecast capital expenditure funding requirement to 2019/20 is summarised below showing a total requirement of £367m between 2017/18 and 2019/20. The borrowing values below are used throughout this report.

	2016-17 Forecast £000	2017-18 Forecast £000	2018-19 Forecast £000	2019-20 Forecast £000
Base Investment Programme	88,779	163,644	357,963	406,821
Base TfWM Transport Programme	16,679	7,567	4,600	4,600
TOTAL BASE PROGRAMME	**105,458**	**171,211**	**362,563**	**411,421**
Funded By:				
3rd Party & Private	7,415	5,000	4,580	1,307
DFT & Central Government	59,474	71,263	107,195	199,025
European Union	750	-	-	-
Highways England	-	-	19,000	19,506
LEP Funding (LGF / Growth Deal / EZ)	20,002	19,015	47,018	24,080
Local Authority	3,022	6,352	5,215	7,863
Network Rail	-	-	5,100	7,400
Other Funding	-	2,093	2,940	2,426
Revenue	549	218	250	250
Total Funding Available	**91,212**	**103,940**	**191,298**	**261,858**
Balance to be Funded by WMCA	**14,246**	**67,271**	**171,265**	**149,563**
WMCA Funding				
Borrowing	9,656	62,234	164,934	140,140
Use of MRP	4,590	5,036	6,332	9,423
Total WMCA Funding	**14,246**	**67,271**	**171,265**	**149,563**

9.2 Whilst the table indicates a £10m borrowing requirement during 2016/17, no actual borrowing is expected to be undertaken as the requirement is expected to be met from available cash resources. It is possible that there will be a need to borrow during 2017/18 as indicated by the requirement above, but this will depend upon the progression of schemes within the WMCA Investment Programme and the available cash resources during the year.

9.3 WMCA have placed processes in place to ensure that where available cash balances are used to suppress borrowing requirements, this use of cash does not introduce a detrimental impact against the revenue streams or financial models relating to the Devolution Deal / Investment Programme.

9.4 Borrowing in advance of need: The WMCA has some flexibility to borrow funds in year for use in future years. The Section 151 Officer to WMCA may do this under delegated power where, for instance, a sharp rise in interest rates is expected, and so borrowing early at fixed rates will be economically beneficial to meet budgetary constraints. Whilst the Section 151 Officer to WMCA will adopt a cautious approach to any such borrowing, where there is a clear business case for doing so borrowing may be undertaken to fund the approved capital programme or to fund future debt maturities. Timing and actual borrowing levels undertaken in year will depend on cash flows and working capital requirements.

9.5 Risks associated with any advance borrowing activity will be subject to appraisals in advance and subsequent reporting through the mid-year or annual reporting.

9.6 In 2017 / 2018, it is possible that the WMCA would be likely to borrow at least some of its emerging borrowing needs on a short term or variable rate basis to take advantage of current low short term rates. This strategy and its implementation will remain flexible to adapt to changing risks and circumstances. The strategy will be kept under review by the Section 151 Officer to the WMCA and reported through regular monitoring reports.

10.0 Investments

10.1 As detailed above, the Bank of England Base rate was reduced to 0.25% in August 2016 and as such, returns on existing investments have been low.

10.2 Returns to March 2017 are expected to be very low with rates between April 2016 and January 2017 ranging from 0.25% to 1.00%, depending upon the individual institutions need for cash. Particularly since the base rate change, 2016/17 has seen downwards movements in rates across all investment products and this is expected to continue into 2017/18.

10.3 Given the increasing risk and continued low returns from short-term unsecured bank investments, the Authority aims to diversify into more secure and / or higher yielding asset classes during 2017/18 where prudently able to do so.

11.0 Minimum Revenue Provision

11.1 The WMCA is required to provide for the repayment of long term capital programme borrowing through a revenue charge (the Minimum Revenue Provision or MRP). Capital Finance Regulations require the approval of an MRP Statement setting out the authority's approach. The MRP statement proposed for approval which remains unchanged from 2016/17 is as follows:-

- *"For capital expenditure incurred before 1 April 2009 or which in future will be financed by supported borrowing, the WMCA will follow previous practice, with MRP broadly based as being 2% of the underlying Capital Financing Requirement.*

- *From 1 April 2009 for all capital expenditure met from unsupported or prudential borrowing, MRP will be based on the estimated life of the asset or a depreciation calculation."*

- *For the existing Transport Delivery Programme MRP will continue to commence in the year after the scheme becomes operational.*

- *In relation to the WMCA wider Devolution Investment Programme MRP will be charged over the 30 years to 2046/47 in order to repay all the Investment Plan borrowing.*

12.0 Use of Reserves

12.1 The Authority has no reserves set aside for funding the capital programme and the projected 31st March 2017 reserves of only £1.5m are exceptionally low and significantly below the recommended level of 7.5% of revenue (£12.2m). Given the forecast Investment Programme, this needs to be carefully monitored.

13.0 Prudential Code

13.1 The Local Government Act 2003 and associated CIPFA Prudential Code for Capital Finance in Local Authorities has set the framework for the new local government capital finance system. From the 2004/05 financial year, Authorities can borrow whatever sums they see fit to support their capital programmes, subject to them being able to afford the revenue costs. This is a fundamental feature of the current system and requires that the Authority sets and monitors a number of Prudential Indicators (PIs) relating to capital, affordability, external debt and treasury management.

13.2 These indicators will be used by the Treasury Management Group to monitor against the CIPFA requirements and can be split into the following categories:

- Affordability

- Prudence

- Capital expenditure, external debt and treasury management.

13.3 Appendix 2 details the Prudential and Treasury Management Indicators for the period.

14.0 West Midlands Combined Authority – Wider Devolution Investment Programme

14.1 The West Midlands Combined Authority is responsible for consolidating and reporting the progress of the Devolution Deal from central government in addition to undertaking the necessary borrowing to facilitate scheme delivery.

14.2 The Devolution deal enables the Combined Authority to create an investment fund of over circa £2 billion through a 30 year revenue stream and locally raised finance. Delivery of the devolution deal commenced in 2016 / 17.

14.3 From April 2016, the West Midlands Combined Authority is the recipient of the 30 year revenue grant (£36.5m per annum) upon which, the borrowing required to fund the investment is secured. Following this, in May 2017, a Mayor will have the option, on the basis of support from business, to raise a business rate supplement to help fund the full programme of works

14.4 A detailed financial model has been assembled which shows that the investment from Government, together with supplementary funding both generated by the Combined Authority and secured at a local level by project sponsors (in most cases, Local Authorities) is sufficient to fund the overall programme of works over a 30 year period, subject to the supplementary funding streams being realised an number of which are still being negotiated and finalised.

14.5 The Authority already has borrowing powers to support Transport Investment and the government have announced that they will allow the Mayor to have further borrowing powers, subject to agreeing a cap with government. No details are available on how this will be applied, but for the purposes of this report it is assumed that the WMCA will be able to undertake all necessary borrowing.

14.6 As detailed within this strategy, any borrowing undertaken by the West Midlands Combined Authority will be based on the availability of cash resources available to the Authority at the time so as to avoid un-necessary interest charges.

14.7 The 2017/18 current estimated programme spend is shown below along with the assumed funding:

INVESTMENT PROGRAMME FUNDING 2017 / 2018	Total Forecast Spend	FUNDED BY (£000)							
		WMCA Devolution Funding	Department For Transport	Private / Banking Sector	LEPs (LGF / Growth Deal)	Central Government Other	Enterprise Zone	Local Authority	Other Funding
UKC HS2 Interchange	7,683	5,604	-	-	-	78	-	-	2,000
Curzon Street Station Masterplan	-	-	-	-	-	-	-	-	-
Adderley St Digbeth Metro Extension	3,521	-	2,698	-	823	-	-	-	-
Metro Birmingham Interchange	1,500	-	1,500	-	-	-	-	-	-
UK Central Infrastructure	16,158	16,135	-	-	-	23	-	-	-
HS2 Connectivity Programme	40,331	12,299	14,145	1,000	1,950	-	4,528	6,316	93
Brierley Hill Metro Extension	2,000	-	2,000	-	-	-	-	-	-
High Speed Supply Chain	4,000			4,000					
HS2 College	9,482	-	-	-	5,066	4,380	-	36	-
HS2 Programme Team	599	599	-	-	-	-	-	-	-
HS2 Growth Strategy	**85,273**	**34,637**	**20,343**	**5,000**	**7,839**	**4,481**	**4,528**	**6,352**	**2,093**
Coventry UK Central	11,422	945	4,237	-	6,240	-	-	-	-
Coventry City Centre Regeneration	11,274	11,274	-	-	-	-	-	-	-
Collective Investment Vehicle	10,415	10,415	-	-	-	-	-	-	-
Land Reclaimation	10,000	10,000	-	-	-	-	-	-	-
Devolved Transport Investment	35,260		35,260						
GRAND TOTAL	**163,644**	**67,271**	**59,840**	**5,000**	**14,079**	**4,481**	**4,528**	**6,352**	**2,093**

14.8 As shown above, the projected borrowing requirement for the programme in 2017/18 is £67.2m which is analysed between transport and non-transport below.

WMCA Investment Programme Financing Analysis 2017/18	Total WMCA Borrowing £000	Transport £000	Non-Transport £000
UKC HS2 Interchange	5,604	5,604	
UK Central Infrastructure	16,135	16,135	
HS2 Connectivity Programme	12,299	12,299	
HS2 Programme Team	599	599	
Coventry UK Central	945	945	
Coventry City Centre Regeneration	11,274		11,274
Collective Investment Vehicle	10,415		10,415
Land Reclaimation	10,000		10,000
TOTAL	**67,271**	**35,582**	**31,689**

14.9 In relation to the Land Reclamation and Collective Investment Vehicle and Coventry City Centre Regeneration, until non-transport powers are granted to WMCA, it is proposed that the lead Authority for each undertakes the borrowing and WMCA underwrite the risk and interest costs until it has the appropriate powers to undertake borrowing itself.

15.0 Monitoring

15.1 Officers will monitor the Performance Indicators on a monthly basis, in particular the Authorised Limit, before any new borrowing is carried out. The monitoring of the Performance Indicators will be reported in the Authority's mid-year Treasury Management Monitoring Report, Financial Monitoring reports and also the out-turn report for the year.

16.0 Financial Implications

16.1 These are included in the body of this report

17.0 Legal Implications

17.1 Legal requirements are referred to in the body of this report.

18.0 Equalities Implications

18.1 There are no Equalities Implications

APPENDIX 1

WEST MIDLANDS COMBINED AUTHORITY INVESTMENT STRATEGY AND POLICY

Investment Strategy

1.1 The Authority holds invested funds representing income received in advance of expenditure plus balances and reserves held. Due to planned capital investment against the ITA legacy Programme, a reduction in investment balances will occur but this will be off-set by additional grant received as part of the WMCA Investment Programme / Devolution Deal.

1.2 As detailed previously, WMCA have placed processes in place to ensure that where available cash balances are used to suppress borrowing requirements, this use of cash does not introduce a detrimental impact against the revenue streams or financial models relating to the Devolution Deal / Investment Programme.

1.3 **Objectives:** Both the CIPFA Code and the CLG Guidance require 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 receiving unsuitably low investment income.

1.4 **Strategy:** Given the increasing risk and falling returns from short-term unsecured bank investments, the Authority aims to diversify into more secure and/or higher yielding asset classes during 2017/18.

1.5 The proposed Investment Policy is:

1.6 **Approved Counterparties:** The Authority may invest its surplus funds with any of the counterparty types in the table below, subject to the cash limits (per counterparty) and the time limits shown.

Approved Investment Counterparties and Limits

<table>
<tr><th rowspan="2">Credit Rating of Institution or Product</th><th colspan="2">Banks and Building Societies</th><th rowspan="2">Government</th><th rowspan="2">Corporates</th></tr>
<tr><th>Unsecured</th><th>Secured</th></tr>
<tr><td>UK Govt</td><td>N/A</td><td>N/A</td><td>£ Unlimited
50 Yrs Max</td><td>N/A</td></tr>
<tr><td>AAA</td><td rowspan="7">£10m (12 Months Max)</td><td>£50m (5 Yrs) Max</td><td rowspan="4">£10m (3 Yrs) Max</td><td>£10m (2 Yrs) Max</td></tr>
<tr><td>AA+</td><td rowspan="6">£20m (3 Yrs Max)</td><td rowspan="2">£5m (1 Yr) Max</td></tr>
<tr><td>AA</td></tr>
<tr><td>AA-</td><td rowspan="5">£1m (1 Yr) Max</td></tr>
<tr><td>A+</td></tr>
<tr><td>A</td><td rowspan="3">£5m (2yrs) Max</td></tr>
<tr><td>A-</td></tr>
<tr><td>BBB+</td><td>£4m (100 Days)</td><td>£5m (2 Yrs Max)</td></tr>
<tr><td>BBB OR BBB-</td><td colspan="2">£1m (Call)</td><td>N/A</td><td>N/A</td></tr>
<tr><td>Pooled Funds & Money Market</td><td colspan="4">£10m Per Fund</td></tr>
<tr><td>None / Un-rated</td><td>£1m (6 mths)</td><td>N / A</td><td>10% of Total
(25Yrs Max)</td><td>£0.05m (5 Yrs)</td></tr>
</table>

This table must be read in conjunction with the notes below:

1.7 **Credit Rating:** Investment limits are set by reference to the lowest published long-term credit rating from any two from, Fitch, Moody's or Standard & Poor's. 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.

1.8 **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. Unsecured investment with banks rated BBB or BBB- are restricted to overnight deposits at the Authority's current account bank (HSBC) should the rating be reduced.

1.9 **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 highest 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.

1.10 **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 an insignificant risk of insolvency. Investments with the UK Central Government may be made in unlimited amounts for up to 50 years.

1.11 **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 as part of a diversified pool in order to spread the risk widely.

1.12 **Pooled Funds:** Shares in diversified investment vehicles consisting of 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. Money Market Funds that offer same-day liquidity and aim for a constant net asset value 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.

1.13 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.

1.14 **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.

1.15 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.

1.16 **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 and reports in the quality financial press. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may meet the credit rating criteria.

1.17 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.

1.18 **Specified Investments**: The CLG Guidance defines specified investments as those:

- Denominated in pound sterling,
- Due to be repaid within 12 months of arrangement,
- Not defined as capital expenditure by legislation, and
- Invested with one of:
  - The UK Government
  - A UK local authority, parish council or community council, or
  - A body or investment scheme of "high credit quality".

1.19 The Authority defines "high credit quality" organisations and securities as those having a credit rating of BBB+ or higher that are domiciled in the UK or a foreign country with a sovereign rating of AA+ or higher. For money market funds and other pooled funds "high credit quality" is defined as those having a credit rating of A- or higher.

1.20 **Non-specified Investments**: Any investment not meeting the definition of a specified investment is classed as non-specified. The Authority does not intend to make any investments denominated in foreign currencies, nor any that are defined as capital expenditure by legislation, such as company shares. Non-specified investments will therefore be limited to long-term investments, i.e. those that are due to mature 12 months or longer from the date of arrangement, and investments with bodies and schemes not meeting the definition on high credit quality. Limits on non-specified investments are shown in table 2 below.

Table 2: Non-Specified Investment Limits

	Cash Limit
Total Long Term Investments	£8m
Total Investments without credit rating or rated below BBB+	£4m
Total non-specified investments	£12m

Investment Limits:

1.21 To ensure that the Authorities reserves are not exposed in the case of a single default, deposits will be placed in secured investments where possible. All investments will be managed within the parameters detailed below in Table 3 and Table 2 above.

Table 3: 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	£20m per broker
Unsecured investments with Banks / Building Societies	£40m in total
Money Market Funds	£40m in total

APPENDIX 2

WEST MIDLANDS COMBINED AUTHORITY PRUDENTIAL & TREASURY MANAGEMENT INDICATORS

1. Prudential Code

1.1 The Local Government Act 2003 and associated CIPFA Prudential Code for Capital Finance in Local Authorities have set the framework for the new local government capital finance system. From the 2004/05 financial year, Authorities can borrow whatever sums they see fit to support their capital programmes, subject to them being able to afford the revenue costs. This is a fundamental feature of the new system and requires that the Authority sets and monitors a number of Prudential Indicators (PIs) relating to capital, affordability, external debt and treasury management.

1.2 The prudential indicators to be reported are split into the following categories:

- Affordability
- Prudence
- Capital expenditure, external debt and Treasury Management.

2. Affordability

2.1 The fundamental objective in the consideration of the affordability of the Authority's capital plans is to ensure that the level of investment in capital assets proposed means that the total capital investment of the Authority remains within sustainable limits, and in particular to consider its impact on the levy. Affordability is ultimately determined by an acceptable levy increase and the realisation of Devolution Deal financing income streams.

2.2 Indicators should be provided for the forthcoming year and the following 2 years and should take into account all of the resources currently available and estimated for the future together with the totality of the Authority's capital plans, revenue income and revenue expenditure forecasts.

2.3 The Authority is to estimate for the forthcoming financial year and the following 2 financial years the ratio of financing costs to net revenue stream.

2.4 The table below summarises the impact on the net financing to WMCA income ratio, which shows an increase from 8.8% to 12.0% over the four years. The changes in the percentage are driven by £38m of historic, high cost loans maturing over the period, together with an increased borrowing requirement driven mostly by the Investment Programme, which is off-set in the indicator by the expected additional financial inflows into the Combined Authority which are necessary to support the Investment Programme.

		Forecast 2016/17 £000	Forecast 2017/18 £000	Forecast 2018/19 £000	Forecast 2019/20 £000
PWLB Interest Charges - Base		8,728	8,334	6,649	6,035
LOBO Interest Charges		403	403	403	403
Interest on new borrowing	Project Related	121	1,019	3,859	7,672
	Debt Rescheduling	-	31	538	731
Inherited Debt Interest Charges		567	530	528	484
Total Interest Charges		9,819	10,318	11,977	15,326
Investment Income		- 225	- 245	- 245	- 245
MRP		4,590	5,036	6,332	9,423
Net Financing Costs		14,183	15,109	18,063	24,504
Transport Services Levy		124,830	121,542	121,542	121,542
Devoloution Grant		36,500	36,500	36,500	36,500
Business Rates		-	-	35,616	37,116
Mayrol Precept		-	-	6,000	6,120
Investment Fund earnings		-	-	1,296	2,567
Ratio of net financing costs to net revenue streams		8.8%	9.6%	9.0%	12.0%

2.5 The table below shows the impact of the changing finance cost as a proportion of the annual income, with values ranging from favourable 1.7% to adverse 3.3% over the period. The main contributor to the favourable movement in 2016/17 is in relation to the MRP charge adjustment which became effective in April 2016. The remaining variances are heavily influenced by the assumptions regarding borrowing requirements and associated revenue inflows relating to Investment Programme financing during the period.

	2016/17 Forecast £000	2017/18 Forecast £000	2018/19 Forecast £000	2019/20 Forecast £000
Transport Levy	124,830	121,542	121,542	121,542
Investment Programme Financing	36,500	36,500	79,412	82,303
Movement in financing cost	(2,738)	966	2,940	6,685
Change in financing as a Percentage of Income	1.70%	(0.61%)	(1.46%)	(3.28%)

3. Prudence

3.1 The prudential indicator in respect of external debt must be set and revised taking into account affordability. It is through this means that the objective of ensuring that external debt is kept within sustainable, prudent limits is addressed year on year.

3.2 Indicator Requirement – Gross Debt and the Capital Financing Requirement: In order to ensure that over the medium term debt will only be for a capital purpose, the Authority should ensure that gross debt does not, except in the short term, exceed the total of capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years.

3.3 WMCA Plan – Based on the planned capital programme the gross borrowing requirement for the Authority over the next 3 years is calculated as follows:

Borrowing Position		2016/17 Forecast £000	2017/18 Forecast £000	2018/19 Forecast £000	2019/20 Forecast £000
Borrowing at start		163,289	167,654	229,585	394,205
Loan Repayment		(5,291)	(5,303)	(23,317)	(5,327)
Forecast New Borrowing	Project Related Borrowing	9,656	62,234	164,934	140,140
	Debt Rescheduling *	-	5,000	23,003	5,000
Gross Borrowing		167,654	229,585	394,205	534,017

* 2016 / 2017 Debt repayment of £5m met from available cash and not refinanced.

3.4 As detailed above, there is a requirement in the Code to ensure that the estimate for the CFR at the end of 2019/20 is not exceeded by the gross borrowing estimate at the end of 2017/18. This requirement seeks to ensure that over the medium term, debt will only be for a capital purpose.

3.5 The gross borrowing at the end of 2017/18 totals £229m as shown above and is less than the CFR comparator detailed within the code of £560m shown in 4.5 below).

4. Capital Expenditure, External Debt and Treasury Management.

4.1 The Authority is required to set and monitor against specified prudential indicators for capital expenditure, external debt and Treasury Management.

4.2 **Indicator Requirement** - The Authority make reasonable estimates of the total of capital expenditure that it plans to incur during the forthcoming financial year and at least the following 2 years.

4.3 **WMCA Plan** - The Capital and Investment Programmes and funding assumptions can be summarised as follows:

	2016-17 Forecast £000	2017-18 Forecast £000	2018-19 Forecast £000	2019-20 Forecast £000
Programme Total	**105,458**	**171,211**	**362,563**	**411,421**
Funded By:				
3rd Party & Private	7,415	5,000	4,580	1,307
DFT & Central Government	59,474	71,263	107,195	199,025
European Union	750	-	-	-
Highways England	-	-	19,000	19,506
LEP Funding (LGF / Growth Deal / EZ)	20,002	19,015	47,018	24,080
Local Authority	3,022	6,352	5,215	7,863
Network Rail	-	-	5,100	7,400
Other Funding	-	2,093	2,940	2,426
Revenue	549	218	250	250
Available Resources	4,590	5,036	6,332	9,423
Borrowing	9,656	62,234	164,934	140,140
Funding Total	**105,458**	**171,211**	**362,563**	**411,421**

4.4 **Indicator Requirement** - The Authority has to make reasonable estimates of the total capital financing requirement at the end of the forthcoming financial year and the following 2 years.

4.5 **WMCA Plan** – Based upon the WMCA Capital Programme set out throughout this report, the capital financing requirement is calculated as follows:

	2016/17 Forecast £000	2017/18 Forecast £000	2018/19 Forecast £000	2019/20 Forecast £000
Capital Financing Requirement B/F	184,789	194,154	256,085	420,703
Less MRP	(4,590)	(5,036)	(6,332)	(9,423)
Less Annuity Debt Principal Repayment	(291)	(303)	(316)	(320)
Less Government and Other Grants	(91,212)	(103,940)	(191,298)	(261,858)
Capital expenditure	105,458	171,211	362,563	411,421
Closing CFR	194,154	256,085	420,703	560,523

4.6 The estimate of capital financing requirement at the end of each year relates to all capital expenditure including previous years. The capital financing requirement reflects the Authority's underlying need to borrow. The code requires that the gross borrowing position as at 31st March 2018 (£256m as per the table above) should not be greater than the CFR on 31st March 2020 (£560m as shown above).

4.7 **Indicator Requirement** - The Authority is to set for the forthcoming financial year and the following two years an operational boundary for its external debt.

4.8 **WMCA Plan** – Based on the agreed Capital Programme only this is calculated as follows:

Operational Boundary		2016/17 Forecast £000	2017/18 Forecast £000	2018/19 Forecast £000	2019/20 Forecast £000
Long term debt as start of year		163,009	167,374	229,305	393,924
New borrowing requirement	Project Borrowing	9,656	62,234	164,934	140,140
	Debt Rescheduling *	-	5,000	23,003	5,000
Loan maturities		(5,291)	(5,303)	(23,317)	(5,327)
Operational boundary		167,374	229,305	393,924	533,737

* 2016 / 2017 Debt repayment of £5m met from available cash and not refinanced.

4.9 The operational boundary should be based on the Authority's estimate of most likely, i.e. prudent, but not worst case scenario. Risk analysis and risk management strategies should be taken into account. The operational boundary should equate to the maximum level of external debt projected by this estimate. The operational boundary links directly to the Authority's plans for capital expenditure, capital financing estimate and the estimate of cash flow requirement for the year for all purposes.

4.10 **Indicator Requirement** - The Authority is to set for the forthcoming financial year and the following 2 years an authorised limit for its total external debt, gross of investment, separately identifying borrowing from other long term liabilities. The authorised limit provides headroom over and above the operational boundary sufficient for example for unusual cash movements.

4.11 **WMCA plan** – Using the proposed Capital Programme and headroom of £83m to allow for short term borrowing and possible loan rescheduling the authorised limit is proposed to be set as follows:

Authorised Limit		2016/17 Forecast £000	2017/18 Forecast £000	2018/19 Forecast £000	2019/20 Forecast £000
Long term debt as start of year		163,009	167,374	229,305	393,924
New borrowing requirement	Project Borrowing	9,656	62,234	164,934	140,140
	Debt Rescheduling *	-	5,000	23,003	5,000
Loan maturities		(5,291)	(5,303)	(23,317)	5,327
Headroom		83,000	83,000	83,000	83,000
Operational boundary		250,374	312,305	476,924	627,391

* 2016 / 2017 Debt repayment of £5m met from available cash and not refinanced.

4.12 Both the authorised limit and the operational boundary need to be consistent with the Authority's plans for capital expenditure and financing and with its Treasury Management Policy Statement and practices.

4.13 Both the operational boundary and authorised limit are based on the Authority's plans and the Authorised limit includes significant and sufficient headroom in the statutory limit to allow for the possibility that WMCA could be given full borrowing powers from Government at some point.

4.14 **Other Indicator Requirements** - The Authority has to set for the forthcoming financial year and the following two financial year's upper limits to its exposures to the effects of changes in interest rates. These prudential indicators relate to both fixed interest rates and variable interest rates.

4.15 **WMCA Plan** - The indicators are set to ensure that the Authority has clarity over interest rate exposure rather than risk.

Table 11 - Interest Rate Exposure

Maximum Exposure Permitted	Forecast 2016/17	Forecast 2017/18	Forecast 2018/19
Fixed Rate exposure	100%	100%	100%
Variable Rate exposure	30%	30%	30%

4.16 The Authority has adopted the CIPFA Code of Practice for Treasury Management in the Public Services. The purpose of the code to ensure the Authority satisfies eight main purposes:

i. To assist public service organisations in the development and maintenance of firm foundations and clear objectives for their treasury management activities and thereby to add to their credibility in the public eye.

ii. To emphasise the overriding importance of effective risk management as the foundation for treasury management in all public service bodies.

iii. To encourage the pursuit of best value in treasury management, and to promote the reasoned use, development and appreciation of appropriate and practical measures of performance.

iv. To enable CIPFA members to fulfil their professional and contractual responsibilities to the organisations they serve and, in accordance with the members' charter, "to maintain and develop the professional competence of both themselves and those they supervise.

v. To help facilitate a standardisation and codification of treasury management policies and practices in the public services.

vi. To assist those involved in the regulation and review of treasury management in the public services, particularly those charged with the audit of the same.

vii. To foster a continuing debate on the relevance and currency of the statutory and regulatory regimes under which treasury management in the various parts of the public services operates.

viii. To further the understanding and confidence of, and to act as a reference work for, financial and other institutions whose businesses bring them into contact with the treasury management activities of public service organisations.

4.17 The Authority has to set for the forthcoming financial year both upper and lower limits with respect to the maturity structure of its borrowing.

Where the periods in question are:

- Under 12 months
- 12 months and within 24 months
- 24 months and within 5 years
- 5 years and within 10 years
- 10 years and above

Table 12 - Maturity structure of Loans

	Lower Limit %	Upper Limit %	Current Level %
Under 12 Months	0%	20%	3.89%
12 months and within 24 months	0%	30%	17.92%
24 months & within 5 years	0%	40%	7.79%
5 years & within 10 years	0%	60%	0.00%
10 years & within 20 years	0%	100%	10.13%
20 years & within 30 years	0%	100%	4.73%
30 years & within 40 years	0%	100%	27.56%
40 years & within 50 years	0%	100%	27.98%
TOTAL			100.00%

4.18 Where the Authority invests, or plans to invest, for periods longer than 364 days an upper limit for each forward financial year period for the maturing of such investments is set.

4.19 **WMCA plan** - With the current market conditions it is not envisaged that any investments will be placed for over 364 days. However, to give the Fund Managers flexibility a limit of £10m has been set.

APPENDIX 3 - Summary Prudential Indicators

Measure	2016/17 Forecast £000's	2017/18 Forecast £000's	2018/19 Forecast £000's	2019/20 Forecast £000's
Affordability				
Ratio of financing costs to net revenue stream:				
(a) financing costs	14,183	15,109	18,063	24,504
(b) net revenue stream	161,330	158,042	200,954	203,845
Percentage	8.79%	9.56%	8.99%	12.02%
Estimates of Capital Investment on Income (%)	1.71%	(0.59%)	(1.47%)	(3.16%)
Prudence				
Gross borrowing and the capital financing requirement:				
Gross Borrowing (excludes inhereted debt)	167,654	**229,585**	394,205	534,017
Capital Financing Requirement (Gross borrowing in year 2017/18 must not exceed year CFR in 2019/20)	194,154	256,085	420,703	**560,523**
Capital Expenditure, External Debt and Treasury Management				
Capital Expenditure	105,458	171,211	362,563	411,421
Operational boundary for external debt				
Operational boundary for borrowing	167,374	312,305	476,924	627,391
Authorised limit for external debt				
Authorised limit for borrowing	250,374	312,305	476,924	627,391
Interest rate exposures				
Upper limit on fixed rate exposures	10%	10%	10%	10%
Upper limit on variable rate exposures	30%	30%	30%	30%
Investments longer than 364 days				
Upper limit	8,000	8,000	8,000	8,000

CIPFA Treasury Management Code?	**Yes**

Maturity structure of borrowing - limits	Upper Limit '%	Current Level '%	Current Level '%
Under 12 Months	20%	4%	0%
12 months and within 24 months	30%	18%	0%
24 months & within 5 years	40%	8%	0%
5 years & within 10 years	60%	0%	0%
10 years & within 20 years	100%	10%	0%
20 years & within 30 years	100%	5%	0%
30 years & within 40 years	100%	28%	0%

These Indicators will be updated for approval during the year should the onward refinement of the WMCA Wider Devolution Investment Programme spend estimates require it.

Appendix 3: Current Lending list

Institution	Country	Long term Rating			Limit £m	Term Limit £m
		Fitch	Moody's	S & P		
Debt Management Office	UK				unlimited	12 Months
Local Authorities (a)	UK				£10m	12 Months
Local Authorities (b)	UK				£10m	12 Months
HSBC Bank plc	UK	AA-	Aa2	AA-	£10m	13 Months
Lloyds Bank Plc	UK	A+	A1	A	£10m	13 Months
Santander UK Plc	UK	A	Aa3	A	£10m	6 Months
Barclays Bank Plc	UK	A	A2	A-	£10m	100 days
Nationwide Building Society	UK	A	A2	A	£10m	6 Months
Royal Bank of Scotland	UK	BBB+	A3	BBB+	£10m	35 days