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REPORT TO: West of England Combined Authority

DATE: 2nd February 2018

REPORT TITLE: TREASURY MANAGEMENT STRATEGY STATEMENT AND INVESTMENT STRATEGY 2017/18

AUTHOR: Tim Richens – Director of Investments & Corporate Services

Purpose of Report

1. The report sets out Treasury Management Strategy including authorised lending institutions in accordance with the Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice.

Issues for Consideration

2. The WECA is required to adopt the CIPFA Treasury Management in Public services Code of Practice 2011 Edition, which requires the WECA to approve a Treasury Management Strategy before the start of each financial year. In addition, the Department for Communities and Local Government (CLG) issued revised guidance on local WECA investments in March 2010 that requires the WECA to approve an investment strategy before the start of each financial year.

3. CIPFA issued an updated Treasury Management in Public Services: Code of Practice in late December 2017 and the code will be effective for the 2018/19 Financial Year. In accordance with Arlingclose advice we have continued to seek approval of our Treasury Management Strategy (TMS) under the requirements of the 2011 Codes, not least because the new code does not recommend any changes to the format or content of the TMS. CIPFA is currently planning to publish updated guidance notes on the changes to the code later in 2018 and if any changes to this strategy are required they will be reported in future treasury management reports

2018/19 Treasury Management & Investment Strategy

4. The Local Government Act 2003 requires the WECA to 'have regard to' the Prudential Code and to set Treasury Indicators for the next three years to ensure that the WECA's capital investment plans are affordable, prudent and sustainable.

4.1 The Act therefore requires the WECA to set out its treasury strategy for borrowing and to prepare an Investment Strategy; this sets out the Authorities policies for managing its investments and for giving priority to the security and liquidity of those investments.

4.2 The suggested strategy for 2018/19 in respect of the following aspects of the treasury management function is based on officer views on interest rates, supplemented with leading market forecasts provided by the WECA's treasury advisor.

4.3 The strategy covers:

- Treasury limits in force which will limit the treasury risk and activities of the WECA;
- Treasury Management Indicators;
- The current treasury position;
- The borrowing requirement;
- Prospects for interest rates;
- The borrowing strategy;
- The investment strategy.

4.4 It is a statutory requirement under Section 33 of the Local Government Finance Act 1992, for the WECA to produce a balanced budget. In particular, Section 32 requires a local WECA to calculate its budget requirement for each financial year to include the revenue costs that flow from capital financing decisions. This, therefore, means that increases in capital expenditure must be limited to a level whereby the impact on the revenue budget from: -

- charges caused by the financing of capital expenditure, and
- any increases in running costs from new capital projects

are limited to a level which is affordable within the projected income of the WECA for the foreseeable future.

4.5 The revised CIPFA Treasury Management in Public services Code of Practice 2011 Edition, requires the Treasury Management Strategy and policies to be scrutinised by the WECA Audit Committee.

4.6 The proposed Treasury Management Strategy is attached as Appendix 1 and includes the Treasury Management Indicators required by the Treasury Management Code.

4.7 The indicators provide for no borrowing to be undertaken by the WECA during 2018/19 pending further detailed work to be undertaken of project prioritisation and delivery by the WECA. The proposed Budget which will be brought to the WECA on 2nd February 2018 will reflect this position accordingly.

4.8 Appendix 1 also sets out that the WECA will have no debt at 31st March 2018.

4.9 The 2018/19 Investment Strategy is attached at Appendix 2. This sets 'outer limits' for treasury management operations. While the strategy uses credit ratings in a "mechanistic" way to rule out counterparties, in operating within the policy Officers complement this with the use of other financial information when making investment decisions, for example Credit Default Swap (CDS) prices, Individual Ratings, and the financial press.

4.10 The Counterparty listing in Appendix 3 includes credit ratings from three agencies, as well as a sovereign rating for each country. Counterparties who now meet the minimum criteria as recommended in Appendix 2 as at 31st December 2017 are included in the listing in Appendix 3.

4.11 Interest rate forecasts from the WECA's interim Treasury advisors (Arlingclose) are included in Appendix 4.

4.12 The Council has met the conditions to opt up to MiFID II professional status and intends for this to continue in 2018/19 in order to continue to have access to products including money market funds, pooled funds, treasury bills, bonds, shares and to continue to receive the same level of support from our treasury management advisors

Legal Implications

4. This report fulfils the WECA's legal obligation under the Local Government Act 2003 to have regard to both the CIPFA Code and the CLG Guidance when setting the Treasury Management Strategy.

Human Resources Implications

5. None directly – arrangements for the provision of Treasury related services from Bath & North East Somerset Council have been put in place by the interim Chief Finance Officer .

Environmental Implications

6. None directly.

Social Implications

7. None directly.

Economic Implications

8. These are set out within the body of the report and the appendices. The proposed WECA Budget will include appropriate estimates for interest earnings from the short-term investment of WECA cash flows.

Equality Impact Assessment

9. There are no direct implications arising from this report.

Risks, Mitigations and Opportunities

10. The WECA's lending & borrowing list is regularly reviewed during the financial year and credit ratings are monitored throughout the year. All lending/borrowing transactions are within approved limits and with approved institutions. Investment & Borrowing advice is provided by our Treasury Management advisers – Arlingclose.

10.1 The 2011 edition of the CIPFA Treasury Management in the Public Services: Code of Practice requires effective scrutiny of the Treasury Management Strategy and policies. The WECA Audit Committee will carry out this scrutiny.

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RECOMMENDATIONS

The WECA is recommended to:-

1. **Approve the proposed Treasury Management Strategy Statement at Appendix 1.**

2. **Approve the Investment Strategy as detailed in Appendix 2.**

3. **Note that the relevant Budget proposals for 2018/19 will be based upon the assumptions and indicators set out in these strategies.**

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ATTACHMENTS TO THIS REPORT

Appendix 1 - Treasury Management Strategy 2018/19
Appendix 2 - Investment Strategy 2018/19
Appendix 3 - Authorised Lending List
Appendix 4 - Economic and Interest Rate Forecast

TREASURY MANAGEMENT STRATEGY – 2018/2019

Introduction

The WECA is recommended to adopt the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice Fully Revised 2011 Edition (the CIPFA Code) which requires the Authority to approve a treasury management strategy before the start of each financial year.

In addition, the Department for Communities and Local Government (CLG) issued revised guidance on local authority investments in March 2010 that requires the Authority to approve an investment 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 both the CIPFA Code and the CLG Guidance.

As a result of Treasury managements activities the WECA will be 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 risk are therefore central to the WECA's treasury management strategy.

CIPFA issued an updated Treasury Management in Public Services: Code of Practice in late December 2017 and the code will be effective for the 2018/19 Financial Year.

The Arlingclose advice received has been that Local authorities are legally obliged to "have regard" to the Treasury Management Code and the Prudential Code "as amended or reissued from time to time" by relevant Capital Finance Regulations. The Council is awaiting publication, expected later in 2018, by CIPFA of the associated new Treasury Management Code Guidance Notes which will include the Treasury Management indicators, and new DCLG Investment Guidance, so it can fully consider any changes that may be required to the treasury management strategy.

The advice received is therefore to continue to obtain full WECA approval for the 2018/19 Treasury Management Strategy under the requirements of the 2011 Codes, not least because the new code does not recommend any changes to the format or content of the TMS. If any updates are required once further guidance notes are published these will be reported in future treasury management reports.

In accordance with the CLG Guidance, the WECA Committee will be asked to approve a revised Treasury Management Strategy Statement should the assumptions on which this report is based change significantly. Other than code changes, other circumstances would include, for example, a large unexpected change

Treasury Borrowing Limits for 2018/19 to 2020/21

There is a statutory duty under s.3 of the Local Government Act 2003, and supporting regulations, for the WECA to determine and keep under review how much it can afford to borrow. This amount is termed the 'Affordable Borrowing Limit'.

The Authority must have regard to the Prudential Code when setting the Affordable Borrowing Limit. The Code requires an authority to ensure that its total capital investment remains within sustainable limits.

The Affordable Borrowing Limit must include all planned capital investment to be financed by external borrowing and any other forms of liability, such as credit arrangements. The Affordable Borrowing Limit is to be set on a rolling basis for the forthcoming year and two successive financial years.

It is proposed to set this limit at £nil whilst the WECA considers is capital spending plans and priorities in accordance with its approved Assurance Framework.

Treasury Management Indicators for 2018/19 – 2020/21

The Authority measures and manages its exposures to treasury management risks using the following indicators. The Authority is asked to approve the following indicators:

Security: average credit rating
The Authority will measure its exposure to credit risk by monitoring the value-weighted average credit rating of its investment portfolio. Unrated investments are assigned a score based on their perceived risk.

	2018/19
Minimum Portfolio average credit rating	A-

Interest rate exposures
This indicator is set to control the Authority's exposure to interest rate risk. The upper limits on fixed and variable rate interest rate exposures, expressed as an amount of net principal borrowed will be:

	2018/19	**2019/20**	**2020/21**
Upper limit on fixed interest rate exposures	100%	100%	100%
Upper limit on variable interest rate exposures	10%	10%	10%

Fixed rate investments and borrowings are those where the rate of interest is fixed for at least 12 months, measured from the start of the financial year or the transaction date if later. All other instruments are classed as variable rate.

Maturity structure of borrowing
This indicator is set to control the Authority's exposure to refinancing risk. The upper and lower limits on the maturity structure of fixed rate borrowing will be:

	Upper	**Lower**
Under 12 months	50%	0%
12 months and within 24 months	75%	0%
24 months and within five years	75%	0%
Five years and within 10 years	100%	0%
10 years and above	100%	0%

Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment.

Principal sums invested for periods longer than 364 days
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 proportion of total long-term principal sum invested to final maturities over 364 days will be:

	2018/19	**2019/20**	**2020/21**
Limit on proportion of principal invested over 364 days	30%	30%	30%

Borrowing limits
The Authorised limits for external debt include current commitments and proposals in the budget report for capital expenditure, plus additional headroom over and above the operational limit for unusual cash movements.

The Operational boundary for external debt is based on the same estimates as the authorised limit but without the additional headroom for unusual cash movements. This level also factors in the proposed approach to use internal cash-flow and future capital receipts as the preferred financing method for the capital programme.

	2018/19	**2019/20**	**2020/21**
Operational boundary – borrowing Operational boundary – other long-term liabilities Operational boundary – TOTAL	**£nil**	**£nil**	**£nil**
Authorised limit – borrowing Authorised limit – other long-term liabilities Authorised limit – TOTAL	**£nil**	**£nil**	**£nil**

External Context & Prospects for Interest Rates (Arlingclose Ltd)

The Chief Finance Officer has appointed Arlingclose as the interim treasury advisor and part of their service is to assist the Authority to formulate a view on interest rates. The following section gives their commentary on the economic context and views on the prospects for future interest rates.

Economic background: The major external influence on the Authority's treasury management strategy for 2018/19 will be the UK's progress in negotiating its exit from the European Union and agreeing future trading arrangements. The domestic economy has remained relatively robust since the surprise outcome of the 2016 referendum, but there are indications that uncertainty over the future is now weighing on growth. Transitional arrangements may prevent a cliff-edge, but will also extend the period of uncertainty for several years. Economic growth is therefore forecast to remain sluggish throughout 2018/19.

Consumer price inflation reached 3.0% in September 2017 as the post-referendum devaluation of sterling continued to feed through to imports. Unemployment continued to fall and the Bank of England's Monetary Policy Committee judged that the extent of spare capacity in the economy seemed limited and the pace at which the economy can grow without generating inflationary pressure had fallen over recent years. With its inflation-control mandate in mind, the Bank of England's Monetary Policy Committee raised official interest rates to 0.5% in November 2017.

In contrast, the US economy is performing well and the Federal Reserve is raising interest rates in regular steps to remove some of the emergency monetary stimulus it has provided for the past decade. The European Central Bank is yet to raise rates, but has started to taper its quantitative easing programme, signalling some confidence in the Eurozone economy.

Credit outlook: High profile bank failures in Italy and Portugal have reinforced concerns over the health of the European banking sector. Sluggish economies and fines for pre-crisis behaviour continue to weigh on bank profits, and any future economic slowdown will exacerbate concerns in this regard.

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. In addition, the largest UK banks will ringfence their retail banking functions into separate legal entities during 2018. There remains some uncertainty over how these changes will impact upon the credit strength of the residual legal entities.

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 remain very low.

Interest rate forecast: The Authority's treasury adviser Arlingclose's central case is for UK Bank Rate to remain at 0.50% during 2018/19, following the rise from the historic low of 0.25%. The Monetary Policy Committee re-emphasised that any prospective increases in Bank Rate would be expected to be at a gradual pace and to a limited extent.

Future expectations for higher short term interest rates are subdued and on-going decisions remain data dependant and negotiations on exiting the EU cast a shadow over monetary policy decisions. The risks to Arlingclose's forecast are broadly balanced on both sides. The Arlingclose central case is for gilt yields to remain broadly stable across the medium term. Upward movement will be limited, although the UK government's seemingly deteriorating fiscal stance is an upside risk.

Arlingclose Interest Rate Forecasts

Arlingclose central interest rate forecast – November 2017

	Bank Rate	3 month LIBID	12 month LIBID	20-year gilt yield*
Q1 2018	0.50	0.50	0.70	1.85
Q2 2018	0.50	0.50	0.70	1.85
Q3 2018	0.50	0.50	0.70	1.85
Q4 2018	0.50	0.50	0.70	1.85
H1 2019	0.50	0.50	0.80	1.87
H2 2019	0.50	0.50	0.80	1.92
H1 2020	0.50	0.50	0.80	1.97
H2 2020	0.50	0.50	0.80	2.05

*
The Authority can currently borrow from the PWLB at 0.60% above gilt yields

The WECA Budget will assume investment interest rates to remain constant at average rate for 2018/19, reflecting the relatively short-term average duration of investments.

A more detailed economic and interest rate forecast provided by Arlingclose is attached at Appendix 4.

Local Context

Current Portfolio Position

The WECA currently holds no borrowing and this is not expected to change during 2018/19.

Borrowing Strategy

As at 31st March 2018, the WECA will hold no long-term loans, no borrowing is anticipated during 2018/19. Therefore a debt-free strategy will be maintained until such a time as the WECA has been able to determine a more detailed capital strategy together with agreement of a prioritised capital investment programme.

The funding of this programme will then be considered as part of the business case development for specific projects and overall cash flow requirements for programme delivery.

INVESTMENT STRATEGY

Investment Policy

Both the CIPFA Code and the CLG Guidance require the WECA 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 WECA'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.

Investment instruments identified for use in the financial year are listed below under the 'Specified' and 'Non-Specified' Investments categories. Counterparty limits will be as set through the WECA's Treasury Management Practices – Schedules.

The strategy of this policy is to set outer limits for treasury management operations. In times of exceptional market uncertainty, WECA Officers will operate in a more restrictive manner than the policy allows, as has been the case during recent years.

As a result of the second Markets in Financial Instruments Directive (MiFID II), 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 £10 million and the persons authorised to make investment decisions on behalf of the 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 WECA has met the conditions to opt up to MiFID professional status and intends for this to continue in 2018/19 in order continue to have access to products including money market funds, pooled funds, treasury bills, bonds, shares and to continue to receive the same level of support from our treasury management advisors

West of England Revolving Investment Fund (RIF)

The WECA acts as the Accountable Body for the West of England Revolving Investment Fund, holding Government grants until they are ready to be distributed to Local Authorities for infrastructure works over the coming years.

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 predominately with UK Central Government and UK Local Authorities. Any interest earned on these investments is reinvested into the RIF.

Local Growth Fund (LGF)

Similarly WECA also acts as Accountable Body for Local Growth Fund (LGF).

LGF Investments will be made in line with the WECA's overall Treasury Management Strategy. Interest is earmarked to fund the corporate support and governance costs that come with performing the Accountable Body function for the LEP.

Approved Investment Counterparties

The WECA may invest its surplus funds with any of the counterparties in the following table, subject to the cash and time limits shown:

Credit Rating	Banks Unsecured	Banks Secured	Government	Corporates	Registered Providers
UK Central 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 15Years	£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 Month	£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
BBB+	£5m 3 Months	£10m 6 Months	£10m 2 Years	£3m 6 months	£3m 2 Years
BBB	£5m Overnight	£5m 3 Months	N/A	N/A	N/A
None	£1m 6 Months	N/A	£10m 25 Years	£50,000 5 Year	£3m 5 Years
Pooled Funds	£10m Per Fund				

The majority of the WECA's investments will be made for relatively short periods and in higher credit rated investments, giving priority to security and liquidity ahead of yield. However, where the WECA has identified a core cash balance that is not required for any cash outflows in the short term, these funds will be considered suitable for a wider range of investments, with a greater focus on achieving a level of investment income that can support WECA services. These may include long-term investments with registered providers of social housing, small businesses or corporate bond funds where an enhanced return is paid to cover the additional risks presented. Standard risk mitigation techniques, such as wide diversification and external credit assessments, will be employed, and no such investment will be made without a specific recommendation from the WECA's treasury management adviser.

In addition, the WECA may invest with organisations and pooled funds without credit ratings, following an external credit assessment and advice from the WECA's treasury management adviser.

<u>Banks Unsecured</u>
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.

Current Bank Account: The WECA's current accounts are held with National Westminster Bank plc (NatWest), which is close to the bottom of the above credit rating criteria. The WECA will treat NatWest as "high credit quality" for the purpose of making investments that can be withdrawn on the next working day, subject to the bank maintaining a credit rating no lower than BBB-.

<u>Banks Secured</u>
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.

<u>Government</u>
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.

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. They will however only be made following a favourable external credit assessment and on the specific advice of the WECA's treasury management adviser.

Registered Providers
Loans and bonds issued by, guaranteed by or secured on the assets of Registered Providers of Social Housing, formerly known as Housing Associations. These bodies are tightly regulated by the Homes and Communities Agency and, as providers of public services, they retain the likelihood of receiving government support if needed.

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. 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.

Bond, equity and property funds offer enhanced returns over the longer term, but are more volatile in the short term. These allow the WECA 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 WECA's investment objectives will be monitored regularly.

The WECA may consider further investment in the CCLA Property Fund during 2018/19 with a view to providing further diversification and the potential for earning a higher investment yield on the core investment balance the WECA must hold to maintain the "Professional" investor status required under MIFID II. Any future investment is already covered under the existing Investment strategy for pooled funds and any final investment decision is delegated to the S151 Officer.

Risk Assessments & Credit Ratings

The WECA (through is appointed Treasury service provider) uses long-term credit ratings from the three main rating agencies Fitch Ratings Ltd, Moody's Investors Service Inc and Standard & Poor's Financial Services LLC to assess the risk of investment default. The lowest available credit rating will be used to determine credit quality, unless an investment-specific rating is available.

Long-term ratings are expressed on a scale from AAA (the highest quality) through to D (indicating default). Ratings of BBB- and above are described as investment grade, while ratings of BB+ and below are described as speculative grade. The WECA's credit rating criteria are set to ensure that it is unlikely that the WECA will hold speculative grade investments, despite the possibility of repeated downgrades.

Credit ratings are obtained and monitored by the WECA'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 an BBB+ 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.

If further counterparties are identified during the year that meet the minimum credit rating criteria and conform to the other criteria set out in the Treasury Management Practice Schedules, they can be added to the lending list following the agreement of the Chief Financial Officer.

The WECA 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.

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 WECA 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 WECA'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.

Foreign countries

Investments in foreign countries will be limited to those that hold a AAA or AA+ sovereign credit rating from all three major credit rating agencies, and to a maximum of £15m per country for those rated AAA and £10 million per country for those rated AA+. There is no limit on investments in the UK, irrespective of the sovereign credit rating.

Sovereign credit rating criteria and foreign country limits will not apply to investments in multilateral development banks (e.g. the European Investment Bank and the World Bank) or other supranational organisations (e.g. the European Union).

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.

Specified Investments

Specified investments are those expected to offer relatively high security and liquidity, and can be entered into with the minimum of formalities. The CLG Guidance defines specified investments as those:

- denominated in pounds 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 WECA, parish WECA or community WECA, or
  - a body or investment scheme of “high credit quality”.

The WECA defines “high credit quality” organisations as those having a credit rating of A- 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.

Non-Specified Investments

Any investment not meeting the definition of a specified investment is classed as non-specified. The WECA 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 below.

	£m
Total long-term investments	50
Total investments without credit ratings or rated below A-	10
TOTAL	**60**

The time limit for long-term investments in UK Local Authorities & Local Government will be 50 years.

Long-term investments will be limited to 50% of a counterparty's limit where it meets the above credit rating criteria (except the UK Government). The combined value of short-term and long-term investments with any organisation will not exceed the limits for specified investments highlighted above.

Liquidity management

The WECA regularly reviews and updates its cash flow forecasts to determine the maximum period for which funds may prudently be committed.
Limits on long-term investments are set by reference to the WECA's medium term financial plan, levels of reserves and cash flow forecast.

Planned investment strategy for 2018/19

Investments are made in three broad categories:

- Short-term – cash required to meet known cash outflows in the next month, plus a contingency to cover unexpected cash flows over the same period.
- Medium-term – cash required to manage the annual seasonal cash flow cycle, including amounts to cover forecast shortages, planned uses of reserves, and a longer-term contingency.
- Long-term – cash not required to meet cash flows, and used primarily to generate investment income.

Short-term funds are required to meet cash flows occurring in the next month or so, and the preservation of capital and liquidity is therefore of paramount importance. Generating investment returns is of limited concern here, although it should not be ignored. Bank deposit accounts and Money Market Funds will be the main methods used to manage short-term cash.

Medium-term funds which may be required in the next one to twelve months will be managed concentrating on security, with less importance attached to liquidity but a slightly higher emphasis on yield. The majority of investments in this period will be in the form of fixed term deposits with banks and building societies. Preference will continue to be given to investments with UK banks with approved credit ratings.

Cash that is not required to meet any liquidity need can be invested for the longer term with a greater emphasis on achieving returns that will support spending on local WECA services. Decisions on making longer term investments (i.e. over 1 year) will be considered during the year after taking account of the interest rate yield curve, levels of core cash and the amount of temporary internal borrowing related to funding of capital spend. A wider range of instruments, including structured deposits, certificates of deposit, gilts and corporate bonds may be used to diversify the portfolio. The use of external fund managers that have the skills and resources to manage the risks inherent in a portfolio of long-term investments may be considered.

Review Reports

The revised CIPFA Code of Practice requires that both mid year and annual review reports on treasury activities are reported to Full WECA.

Other Matters

The CLG Investment Guidance also requires the WECA to note the following matters each year as part of the investment strategy:

<u>Treasury management advisers</u>
The Chief Financial Officer has appointed Arlingclose Limited as the interim treasury management advisers and receives specific advice on investment, debt and capital finance issues, although responsibility for final decision making remains with the WECA and its officers. The services received include:

- advice and guidance on relevant policies, strategies and reports,
- advice on investment decisions,
- notification of credit ratings and changes,
- other information on credit quality,
- advice on debt management decisions,
- accounting advice,
- reports on treasury performance,
- forecasts of interest rates, and
- training courses.

The quality of this service is monitored by officers on a regular basis, focusing on supply of relevant, accurate and timely information across the headings above.

<u>Investment training</u>
The needs of the staff (either directly employed or those within our appointed treasury service provider) for training in investment management will be assessed every year or when the responsibilities of individual members of staff change.

Staff should 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.

APPENDIX 3

Proposed Counterparty List - Unsecured Bank Investements

2018/19

CRITERIA			FITCH RATINGS			Moody's Ratings		S&P Ratings	
	Duration	Council Limit (£m)	S/Term	L/Term	Support	S/Term	L/Term	S/Term	L/Term
UK Banks	**Sovereign Rating**			**AA+**			**Aa1**		**AAA**
Barclays Bank plc	13 months	10	F1	A	5	P-1	A1	A-1	A
Close Brothers Ltd	13 months	10	F1	A	5	P-1	Aa3		
Goldman Sachs International	13 months	10	F1	A		P-1	A1	A-1	A+
HSBC Bank plc	3 Years	10	F1+	AA-	1	P-1	Aa3	A-1+	AA-
Lloyds Banking Group									
Lloyds Bank plc	13 months	10	F1	A+	5	P-1	Aa3	A-1	A
Bank of Scotland plc	13 months	10	F1	A+	5	P-1	Aa3	A-1	A
Royal Bank of Scotland Group									
National Westminster Bank plc	3 Months	5	F2	BBB+	5	-	A3	A-2	BBB+
Royal Bank of Scotland plc	3 Months	5	F2	BBB+	5	P-2	A3	A-2	BBB+
Santander UK plc **(domiciled in UK)**	13 months	10	F1	A	2	P-1	Aa3	A-1	A
Standard Chartered Bank	2 Years	10	F1	A+	5	P-1	A1	A-1	A
UK Building Societies									
Nationwide	13 months	10	F1	A+	5	P-1	Aa3	A-1	A
Yorkshire	6 months	10	F1	A-	5	P-2	A3	NR	NR
Coventry	13 months	10	F1	A	5	P-1	A2	-	-
Leeds	6 months	10	F1	A-	5	P-2	A3	-	-
Foreign Banks									
Australia	**Sovereign Rating**			**AAA**			**Aaa**		**AAAu**
Australia & New Zealand Banking Group	3 Years	10	F1+	AA-	1	P-1	Aa3	A-1+	AA-
Commonwealth Bank of Australia	3 Years	10	F1+	AA-	1	P-1	Aa3	A-1+	AA-
National Australia Bank Group									
National Australia Bank Ltd	3 Years	10	F1+	AA-	1	P-1	Aa3	A-1+	AA-
Westpac Banking Corporation	3 Years	10	F1+	AA-	1	P-1	Aa3	A-1+	AA-
Canada	**Sovereign Rating**			**AAA**			**Aaa**		**AAA**
Bank of Montreal	2 Years	10	F1+	AA-	2	P-1	A1	A-1	A+
Bank of Nova Scotia	2 Years	10	F1+	AA-	2	P-1	A1	A-1	A+
Canadian Imperial Bank of Commerce	2 Years	10	F1+	AA-	2	P-1	A1	A-1	A+
Royal Bank of Canada	3 Years	10	F1+	AA	2	P-1	A1	A-1+	AA-
Toronto-Dominion Bank	3 Years	10	F1+	AA-	2	P-1	Aa2	A-1+	AA-
Finland	**Sovereign Rating**			**AA+**			**Aa1**		**AA+**
OP Corporate Bank	2 Years	10	F1	A+	5	P-1	Aa3	A-1+	AA-
Germany	**Sovereign Rating**			**AAA**			**Aaa**		**AAAu**
Landesbank Hessen-Thuringen	13 months	10	F1+	A+	WD	P-1	A1	A-1	A
Netherlands	**Sovereign Rating**			**AAA**			**Aaa**		**AAAu**
Bank Nederlandse Gemeenten	5 Years	10	F1+	AA+	1	P-1	Aaa	A-1+	AAA
Cooperatieve Centrale Raiffe	2 Years	10	F1+	AA-		P-1	Aa2	A-1	A+
ING Bank NV	13 months	10	F1	A	5	P-1	A1	A-1	A
Singapore	**Sovereign Rating**			**AAA**			**Aaa**		**AAAu**
Development Bank of Singapore Ltd	3 Years	10	F1+	AA-	1	P-1	Aa1	A-1+	AA-
Oversea-Chinese Banking Corp	3 Years	10	F1+	AA-	1	P-1	Aa1	A-1+	AA-
United Overseas Bank Ltd	3 Years	10	F1+	AA-	1	P-1	Aa1	A-1+	AA-
Sweden	**Sovereign Rating**			**AAA**			**Aaa**		**AAAu**
Svenska Handelsbanken	3 Years	10	F1+	AA-	5	P-1	Aa3	A-1+	AA-
Nordea Bank NV	3 Years	10	F1+	AA	5	P-1	Aa2	A-1+	AA-
Switzerland	**Sovereign Rating**			**AAA**			**Aaa**		**AAAu**
Credit Suisse AG	13 months	10	F1	A	5	P-1	A1	A-1	A
Supernational									
Council of Europe Development	5 Years	10	F1+	AA+		P-1	Aa1	A-1+	AA+
European Bank for Reconstruction & Dev	5 Years	10	F1+	AAA		P-1	Aaa	A-1+	AAA
European Investment Bank	5 Years	10	F1+	AAA		P-1	Aaa	A-1+	AAA
Inter-American Development Bank	5 Years	10	F1+	AAA		(P)P-1	Aaa	A-1+	AAA
IBRD (World Bank)	5 Years	10	F1+	AAA	-	P-1	Aaa	A-1+	AAA
Kreditanstalt Fuer Wiefrauf	5 Years	10	F1+	AAA	1	P-1		A-1+	AAA
Nordic Investment Bank	5 Years	10	-	-	-	P-1	Aaa	A-1+	AAA

Proposed Counterparty List - Unsecured Bank Investements

Summary Guide to Credit Ratings

Rating	Details
AAA	Highest credit quality – lowest expectation of default, which is unlikely to be adversely affected by foreseeable events.
AA	Very high credit quality - expectation of very low default risk, which is not likely to be significantly vulnerable to foreseeable events.
A	High credit quality - expectations of low default risk which may be more vulnerable to adverse business or economic conditions than is the case for higher ratings.
BBB	Good credit quality - expectations of default risk are currently low but adverse business or economic conditions are more likely to impair this capacity.
BB	Speculative - indicates an elevated vulnerability to default risk, particularly in the event of adverse changes in business or economic conditions over time.
B	Highly speculative - indicates that material default risk is present, but a limited margin of safety remains. Capacity for continued payment is vulnerable to deterioration in the business and economic environment.
CCC	Substantial credit risk - default is a real possibility.
CC	Very high levels of credit risk - default of some kind appears probable.
C	Exceptionally high levels of credit risk - default is imminent or inevitable.
RD	Restricted default - indicates an issuer that has experienced payment default on a bond, loan or other material financial obligation but which has not entered into bankruptcy filings, administration, receivership, liquidation or other formal winding-up procedure, and which has not otherwise ceased
D	Default - indicate san issuer that has entered into bankruptcy filings, administration, receivership, liquidation or other formal winding-up procedure, or which has otherwise ceased business.

Arlingclose Economic & Interest Rate Forecast

Underlying assumptions:

- In a 7-2 vote, the MPC increased Bank Rate in line with market expectations to 0.5%. Dovish accompanying rhetoric prompted investors to lower the expected future path for interest rates. The minutes re-emphasised that any prospective increases in Bank Rate would be expected to be at a gradual pace and to a limited extent.
- Further potential movement in Bank Rate is reliant on economic data and the likely outcome of the EU negotiations. Policymakers have downwardly assessed the supply capacity of the UK economy, suggesting inflationary growth is more likely. However, the MPC will be wary of raising rates much further amid low business and household confidence.
- The UK economy faces a challenging outlook as the minority government continues to negotiate the country's exit from the European Union. While recent economic data has improved, it has done so from a low base: UK Q3 2017 GDP growth was 0.4%, after a 0.3% expansion in Q2.
- Household consumption growth, the driver of recent UK GDP growth, has softened following a contraction in real wages, despite both saving rates and consumer credit volumes indicating that some households continue to spend in the absence of wage growth. Policymakers have expressed concern about the continued expansion of consumer credit; any action taken will further dampen household spending.
- Some data has held up better than expected, with unemployment continuing to decline and house prices remaining relatively resilient. However, both of these factors can also be seen in a negative light, displaying the structural lack of investment in the UK economy post financial crisis. Weaker long term growth may prompt deterioration in the UK's fiscal position.
- The depreciation in sterling may assist the economy to rebalance away from spending. Export volumes will increase, helped by a stronger Eurozone economic expansion.
- Near-term global growth prospects have continued to improve and broaden, and expectations of inflation are subdued. Central banks are moving to reduce the level of monetary stimulus.
- Geo-political risks remains elevated and helps to anchor safe-haven flows into the UK government bond (gilt) market.

Forecast:

- The MPC has increased Bank Rate, largely to meet expectations they themselves created. Future expectations for higher short term interest rates are subdued. On-going decisions remain data dependant and negotiations on exiting the EU cast a shadow over monetary policy decisions.

- Our central case for Bank Rate is 0.5% over the medium term. The risks to the forecast are broadly balanced on both sides.
- The Arlingclose central case is for gilt yields to remain broadly stable across the medium term. Upward movement will be limited, although the UK government's seemingly deteriorating fiscal stance is an upside risk.

	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Average
Official Bank Rate														
Upside risk	0.00	0.00	0.00	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	**0.19**
Arlingclose Central Case	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**
Downside risk	0.00	0.00	0.00	0.00	0.00	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	**-0.15**
3-month LIBID rate														
Upside risk	0.10	0.10	0.10	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	**0.22**
Arlingclose Central Case	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**
Downside risk	-0.10	-0.10	-0.15	-0.15	-0.15	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	**-0.20**
1-yr LIBID rate														
Upside risk	0.15	0.15	0.20	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	**0.27**
Arlingclose Central Case	**0.70**	**0.70**	**0.70**	**0.70**	**0.80**	**0.80**	**0.80**	**0.80**	**0.80**	**0.80**	**0.80**	**0.80**	**0.80**	**0.77**
Downside risk	-0.15	-0.20	-0.30	-0.30	-0.30	-0.30	-0.30	-0.30	-0.30	-0.30	-0.30	-0.15	-0.15	**-0.26**
5-yr gilt yield														
Upside risk	0.20	0.25	0.25	0.25	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	**0.32**
Arlingclose Central Case	**0.75**	**0.75**	**0.80**	**0.80**	**0.80**	**0.85**	**0.90**	**0.90**	**0.95**	**0.95**	**1.00**	**1.05**	**1.10**	**0.89**
Downside risk	-0.20	-0.20	-0.25	-0.25	-0.25	-0.35	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	**-0.33**
10-yr gilt yield														
Upside risk	0.20	0.25	0.25	0.25	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	**0.32**
Arlingclose Central Case	**1.25**	**1.25**	**1.25**	**1.25**	**1.25**	**1.30**	**1.30**	**1.35**	**1.40**	**1.45**	**1.50**	**1.55**	**1.55**	**1.36**
Downside risk	-0.20	-0.25	-0.25	-0.25	-0.25	-0.30	-0.35	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	**-0.33**
20-yr gilt yield														
Upside risk	0.20	0.25	0.25	0.25	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	**0.32**
Arlingclose Central Case	**1.85**	**1.85**	**1.85**	**1.85**	**1.85**	**1.90**	**1.90**	**1.95**	**1.95**	**2.00**	**2.05**	**2.05**	**2.05**	**1.93**
Downside risk	-0.20	-0.30	-0.25	-0.25	-0.30	-0.35	-0.40	-0.45	-0.50	-0.50	-0.50	-0.50	-0.50	**-0.38**
50-yr gilt yield														
Upside risk	0.20	0.25	0.25	0.25	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	**0.32**
Arlingclose Central Case	**1.70**	**1.70**	**1.70**	**1.70**	**1.70**	**1.75**	**1.80**	**1.85**	**1.90**	**1.95**	**1.95**	**1.95**	**1.95**	**1.82**
Downside risk	-0.30	-0.30	-0.25	-0.25	-0.30	-0.35	-0.40	-0.45	-0.50	-0.50	-0.50	-0.50	-0.50	**-0.39**