Cambridgeshire and Peterborough Combined Authority

Treasury Management Strategy Statement ~~2020/21~~2021/22

Introduction

Treasury management is the management of the Authority's cash flows, borrowing and investments, and the associated risks. The Authority has invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of financial risk are therefore central to the Authority's prudent financial management.

Treasury risk management at the Authority is conducted within the framework of the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice 2017 Edition* (the CIPFA Code) which requires the Authority to approve a treasury management strategy before the start of each financial year. This report fulfils the Authority's legal obligation under the *Local Government Act 2003* to have regard to the CIPFA Code.

Investments held for service purposes or for commercial profit are considered in a different report, the Investment Strategy.

~~**External Context**~~

Economic background: The ~~UK's progress negotiating its exit~~ impact on the UK from ~~the European Union, together with its future~~ coronavirus, lockdown measures, the rollout of vaccines, as well as the new trading arrangements~~,~~ with the European Union (EU), will ~~continue to be a~~ remain major ~~influence~~influences on the Authority's treasury management strategy for ~~2020/21. More immediately, the effect of the coronavirus epidemic has depressed~~ 2021/22.

The Bank of England (BoE) maintained Bank Rate at 0.10% in December 2020 and Quantitative Easing programme at £895 billion having extended it by £150 billion in the previous month. The Monetary Policy Committee (MPC) voted unanimously for both, but no mention was made of the potential future use of negative interest rates. In the November Monetary Policy Report (MPR) forecasts, the Bank expects the UK economy to shrink -2% in Q4 2020 before growing by 7.25% in 2021, lower than the previous forecast of 9%. The BoE also forecasts the economy will now take until Q1 2022 to reach its pre-pandemic level rather than the end of 2021 as previously forecast. By the time of the December MPC announcement, a COVID-19 vaccine was approved for use, which the Bank noted would reduce some of the downside risks to the economic ~~activity in some countries~~outlook outlined in the November MPR.

UK Consumer Price Inflation (CPI) for November 2020 registered 0.3% year on year, down from 0.7% in the previous month. Core inflation, which excludes the more volatile components, fell to 1.1% from 1.5%. The most recent labour market data for the three months to October 2020 showed the unemployment rate rose to 4.9% while the employment rate fell to 75.2%. Both measures are expected to deteriorate further due to the ongoing impact of coronavirus on the jobs market, particularly ~~China, and is likely to have damaging repercussions for the~~ when the various government job retention schemes start to be unwound in 2021, with the BoE forecasting unemployment will peak at 7.75% in Q2 2021. In October, the headline 3-month average annual growth rate for wages were 2.7% for total pay and 2.8% for regular pay. In real terms, after adjusting for inflation, total pay growth was up by 1.9% while regular pay was up 2.1%.

GDP growth rebounded by 16.0% in Q3 2020 having fallen by -18.8% in the second quarter, with the annual rate rising to -8.6% from -20.8%. All sectors rose quarter-on-quarter, with dramatic gains in construction (41.2%), followed by services and production (both 14.7%). Monthly GDP estimates have shown the economic recovery slowing and remains well below its pre-pandemic peak. Looking ahead, the BoE's November MPR forecasts economic growth will rise in 2021 with GDP reaching 11% in Q4 2021, 3.1% in Q4 2022 and 1.6% in Q4 2023.

GDP growth in the euro zone rebounded by 12.7% in Q3 2020 after contracting by -3.7% and -11.8% in the first and second quarters, respectively. Headline inflation, however, remains extremely weak, registering -0.3% year-on-year in November, the fourth successive month of deflation. Core inflation registered 0.2% y/y, well below the European Central Bank's (ECB) target of 'below, but close to 2%'. The ECB is expected to continue holding its main interest rate of 0% and deposit facility rate of -0.5% for some time but expanded its monetary stimulus in December 2020, increasing the size of its asset purchase scheme to €1.85 trillion and extended it until March 2022.

The US economy contracted at an annualised rate of 31.4% in Q2 2020 and then rebounded by 33.4% in Q3. The Federal Reserve maintained the Fed Funds rate at between 0% and 0.25% and announced a change to its inflation targeting regime to a more flexible form of average targeting. The Fed also provided strong indications that interest rates are unlikely to change from current levels over the next three years.

Former vice-president Joe Biden won the 2020 US presidential election. Mr Biden is making tackling coronavirus his immediate priority and will also be reversing several executive orders signed by his predecessor and take the US back into the Paris climate accord and the World Health Organization.

Credit outlook: After spiking in late March as coronavirus became a global ~~economy~~pandemic and then rising again in October/November, credit default swap (CDS) prices for the larger UK banks have steadily fallen back to almost pre-pandemic levels. Although uncertainly around COVID-19 related loan defaults lead to banks provisioning billions for potential losses in the first half of 2020, drastically reducing profits, reported impairments for Q3 were much reduced in some institutions. However, general bank profitability in 2020 and 2021 may be significantly lower than in previous years.

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~~Since first appearing in China in December 2019, the coronavirus has now spread to around 40 countries and caused sharp falls in financial markets as part of a flight to quality into sovereign debt and other perceived 'safe' assets. The longer-term impact of the virus on global growth remains uncertain at the moment but as the number of cases and affected countries grows, the impact increases in severity, particularly given the importance of China in global trade. The Federal Reserve cut the Fed Funds policy rate by 0.50% to 1.0 - 1.25%, in order to restore investor confidence and cushion the impact of the virus on activity. Other central banks have followed suit, but this has not stopped a severe reaction in financial markets as investors project a sharp slowdown in global growth.~~

~~The UK economy flatlined in Q4 2019 as the political uncertainties surrounding the General Election and Brexit weighed on business and household sentiment. UK GDP growth was flat in the fourth quarter of 2019, according to the initial estimate from the Office for National Statistics, down from an upwardly revised 0.5% in Q3. A recovery in various economic indicators in Q1 2020 suggested the resumption of confidence following the Election result , but expectations of a reduction in Bank Rate are high due to the impact of coronavirus.~~

~~**Credit outlook:** Credit Default Swap spreads have remained broadly flat since the start of 2020 and trading in a slightly tighter range compared to the last calendar quarter of 2019. Spreads have risen due to the onset of coronavirus, but remain low historically.~~

~~There were only a few credit updates over the period. Standard & Poor's revised the outlook on Clydesdale Bank to positive (and affirmed the long-term and short-term ratings) to reflect its view that as part of the Virgin Money group it has made good progress increasing its capital buffer and bail-in eligible liabilities. Moody's upgraded the long-term ratings of Barclays Bank Plc (non-ringfenced) to A1 and changed the outlook to stable, reflecting an improved operating performance and profitability prospects of the parent, Barclays Plc, which itself was updated to Baa2.~~

~~**Interest rate outlook:** The global economic outlook has rapidly deteriorated with the escalation and spread of coronavirus (COVID-19) to all regions and concerns over its scale and longevity. The economic shock is affecting both supply and demand sides of economies through disruption to trade; containment efforts by governments, corporates and individuals and the damage to sentiment could halve global growth from 2.9% to 1.5% in 2020 (OECD), with a worse case scenario of a sharper contraction and global recession.~~

~~Central banks have already responded in the US, Canada and Australia with interest rate cuts. Outgoing Bank of England Governor has commented the Bank's response will be "powerful and timely" and, in an emergency meeting on the 11th March 2020, the MPC cut the base rate by 0.5% reducing it to 0.25%.~~

~~The government will outline its public spending intentions in the March Budget and undertake substantial fiscal loosening in 2020/21. The Chancellor is now also expected to announce a package of measures to ease COVID-19's pressure on the health service, consumers and businesses. Nevertheless, activity will also hinge on COVID-19's global economic damage and outcome.~~

~~Chinese activity remains impaired despite a slowdown in cases. As one of the main drivers of global economic growth and its integral position in many global supply chains, a persistent downturn in its economy is having a global spill-over and wide-ranging ramifications. The UK economy is likely to face issues with supply, due to the global impact on supply chains, and demand, as individuals travel less frequently for both work and leisure. Economic growth will therefore be weak for H1 2020. Prior to the virus, the more stable political environment had prompted a partial return in business and household confidence, and a bounce in economic activity and inflation. Whether this can be maintained or at least returned to during this year depends on the extent and duration of the virus impact.~~

	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Average
Official Bank Rate														
Upside risk	0.00	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.23
Arlingclose Central Cas	0.50	0.25	0.25	0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.44
Downside risk	0.50	0.25	0.25	0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.44
3-month money market rate														
Upside risk	0.00	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.30	0.30	0.30	0.30	0.30	0.25
Arlingclose Central Cas	0.50	0.25	0.25	0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.44
Downside risk	0.50	0.25	0.25	0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.44
1yr money market rate														
Upside risk	0.10	0.20	0.20	0.20	0.20	0.20	0.20	0.25	0.30	0.30	0.30	0.30	0.30	0.23
Arlingclose Central Cas	0.65	0.40	0.45	0.60	0.70	0.70	0.70	0.70	0.70	0.70	0.70	0.70	0.70	0.65
Downside risk	0.30	0.30	0.40	0.60	0.60	0.65	0.65	0.65	0.65	0.65	0.65	0.65	0.65	0.57
5yr gilt yield														
Upside risk	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	0.45	0.45	0.45	0.38
Arlingclose Central Cas	0.30	0.20	0.25	0.35	0.60	0.60	0.60	0.65	0.65	0.70	0.70	0.70	0.70	0.54
Downside risk	0.35	0.35	0.40	0.55	0.60	0.60	0.60	0.65	0.65	0.70	0.70	0.70	0.70	0.58
10yr gilt yield														
Upside risk	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	0.40	0.45	0.45	0.37
Arlingclose Central Cas	0.50	0.40	0.45	0.60	0.65	0.70	0.70	0.75	0.75	0.80	0.80	0.85	0.85	0.68
Downside risk	0.50	0.50	0.60	0.70	0.65	0.70	0.65	0.70	0.70	0.70	0.70	0.70	0.70	0.65
20yr gilt yield														
Upside risk	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	0.40	0.45	0.45	0.37
Arlingclose Central Cas	0.75	0.70	0.75	0.80	0.85	0.85	0.90	0.90	0.95	0.95	1.00	1.00	1.05	0.88
Downside risk	0.50	0.50	0.60	0.70	0.65	0.70	0.65	0.70	0.70	0.70	0.70	0.70	0.70	0.65
50yr gilt yield														
Upside risk	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	0.40	0.45	0.45	0.37
Arlingclose Central Cas	0.75	0.70	0.75	0.80	0.85	0.85	0.90	0.90	0.95	0.95	1.00	1.00	1.05	0.88
Downside risk	0.50	0.50	0.60	0.70	0.65	0.70	0.65	0.70	0.70	0.70	0.70	0.70	0.70	0.65

~~PWLB Certainty Rate (Maturity Loans) = Gilt yield + 1.80%~~

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

The credit ratings for many UK institutions were downgraded on the back of downgrades to the sovereign rating. Credit conditions more generally though in banks and building societies have tended to be relatively benign, despite the impact of the pandemic.

Looking forward, the potential for bank losses to be greater than expected when government and central bank support starts to be removed remains a risk, suggesting a cautious approach to bank deposits in 2021/22 remains advisable.

Interest rate forecast: The Authority's treasury management adviser Arlingclose is forecasting that BoE Bank Rate will remain at 0.1% until at least the first quarter of 2024. The risks to this forecast are judged to be to the downside as the BoE and UK government continue to react to the coronavirus pandemic and the new EU trading arrangements. The BoE extended its asset purchase programme to £895 billion in November while keeping Bank Rate on hold and maintained this position in December. However, further interest rate cuts to zero, or possibly negative, cannot yet be ruled out but this is not part of the Arlingclose central forecast.

Gilt yields are expected to remain very low in the medium-term while short-term yields are likely remain below or at zero until such time as the BoE expressly rules out the chance of negative interest rates or growth/inflation prospects improve. The central case is for 10-year and 20-year to rise to around 0.60% and 0.90% respectively over the time horizon. The risks around the gilt yield forecasts are judged to be broadly balanced between upside and downside risks, but there will almost certainly be short-term volatility due to economic and political uncertainty and events.

Table 1 Arlingclose Interest Rate Forecast – January 2021

	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24
Official Bank Rate													
Upside risk	0.00	0.00	0.15	0.15	0.15	0.15	0.30	0.30	0.30	0.30	0.30	0.30	0.30
Arlingclose Central Case	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
Downside risk	0.30	0.40	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
3-month money market r													
Upside risk	0.05	0.05	0.10	0.10	0.15	0.20	0.30	0.30	0.30	0.30	0.30	0.30	0.30
Arlingclose Central Case	0.10	0.10	0.15	0.15	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20
Downside risk	0.30	0.40	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
1yr money market rate													
Upside risk	0.05	0.05	0.10	0.10	0.15	0.20	0.40	0.40	0.40	0.40	0.40	0.40	0.40
Arlingclose Central Case	0.15	0.15	0.25	0.25	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30
Downside risk	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.15
5yr gilt yield													
Upside risk	0.40	0.40	0.45	0.45	0.50	0.50	0.55	0.60	0.60	0.65	0.65	0.70	0.70
Arlingclose Central Case	0.00	0.00	0.05	0.10	0.15	0.20	0.20	0.20	0.25	0.25	0.25	0.25	0.25
Downside risk	0.40	0.45	0.50	0.55	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.60
10yr gilt yield													
Upside risk	0.30	0.35	0.40	0.45	0.50	0.50	0.55	0.60	0.60	0.65	0.65	0.70	0.70
Arlingclose Central Case	0.25	0.30	0.35	0.35	0.40	0.40	0.45	0.45	0.50	0.55	0.55	0.55	0.60
Downside risk	0.50	0.50	0.55	0.55	0.55	0.55	0.55	0.55	0.55	0.55	0.55	0.55	0.55
20yr gilt yield													
Upside risk	0.40	0.40	0.45	0.45	0.50	0.50	0.55	0.60	0.60	0.65	0.65	0.70	0.70
Arlingclose Central Case	0.70	0.70	0.75	0.75	0.75	0.80	0.80	0.85	0.85	0.85	0.85	0.90	0.90
Downside risk	0.30	0.30	0.35	0.35	0.35	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40
50yr gilt yield													
Upside risk	0.40	0.40	0.45	0.45	0.50	0.50	0.55	0.60	0.60	0.65	0.65	0.70	0.70
Arlingclose Central Case	0.60	0.60	0.65	0.65	0.65	0.70	0.70	0.75	0.75	0.75	0.75	0.80	0.80
Downside risk	0.30	0.30	0.35	0.35	0.35	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40

PWLB Certainty Rate (Maturity Loans) = Gilt yield + 0.80%
PWLB Infrastructure Rate (Maturity Loans) = Gilt yield + 0.60%

Local Context

On ~~29th February~~31st December 2020 the Authority held £nil borrowing and £~~170.2m~~187.5m of treasury investments.

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 Authority is currently debt free and its capital expenditure plans do not currently imply any need to borrow over the forecast period. Investments are forecast to fall from current levels (end of ~~Feb~~Dec 2020) of £~~170m~~188m to £~~22m~~23m (end Mar ~~2024~~2025) as capital funding is used to finance capital expenditure as set out in the Capital programme and the Medium-Term Financial Plan.

CIPFA's *Prudential Code for Capital Finance in Local Authorities* recommends that the Authority's total debt should be lower than its highest forecast CFR over the next three years.

The Authority expects that its capital financing requirement will be nil on 31st March ~~2020~~2021 and in line with the MHCLG Guidance it expects to charge no MRP in ~~2020/21~~2021/22. The Combined Authority has no current requirement to borrow over the lifetime of the Medium Term Financial Plan and so the forecast CFR until ~~2024~~2025 is £nil.

Borrowing Strategy

The Authority is not currently ~~does not hold~~in receipt of any loans. The balance sheet forecast shows that the Authority does not expect to need to borrow in ~~2020/21~~2021/22. However, the Authority may borrow to pre-fund future years' requirements, providing this does not exceed the authorised limit for borrowing of £84.61 million.

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

Strategy: The Authority's borrowing strategy will address the key issue of affordability without compromising the longer-term stability of any future debt portfolio. With short-term interest rates currently much lower than long-term rates, it is likely to be more cost effective in the short-term to either use internal resources, or to borrow short-term loans instead.

The benefits of internal / short-term borrowing will be monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing rates are forecast to rise modestly. Arlingclose will assist the Authority with this 'cost of carry' and breakeven analysis. Its output may determine whether the Authority borrows additional sums at long-term fixed rates in ~~2020/21~~2021/22 with a view to keeping future interest costs low, even if this causes additional cost in the short-term.

The government ~~increased~~ has reversed the 1% increase in PWLB rates ~~by 1%~~introduced in October 2019 ~~making it now~~. As a ~~relatively expensive option. The~~result of this, the Authority ~~will now look~~expects to borrow any long-term loans from the PWLB, but will consider long-term loans from other sources including banks, pensions and local authorities, and will investigate the possibility of issuing bonds and similar instruments, in order to lower interest costs and reduce over-reliance on one source of funding in line with the CIPFA Code. PWLB loans are no longer available to local authorities planning to buy investment assets primarily for yield; the Authority intends to avoid this activity in order to retain its access to PWLB loans.

Alternatively, the Authority may arrange forward starting loans, where the interest rate is fixed in advance, but the cash is received in later years. This would enable certainty of cost to be achieved without suffering a cost of carry in the intervening period.

In addition, the Authority may borrow short-term loans to cover unplanned cash flow shortages.

Sources of borrowing: The approved sources of long-term and short-term borrowing are:

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

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

- leasing
- hire purchase
- Private Finance Initiative

- sale and leaseback

Municipal Bonds Agency: UK Municipal Bonds Agency plc was established in 2014 by the Local Government Association as an alternative to the PWLB. It ~~plans to issue~~issues bonds on the capital markets and ~~lend~~lends the proceeds to local authorities. This ~~will be~~is a more complicated source of finance than the PWLB for two reasons: borrowing authorities will be required to provide bond investors with a 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. Any decision to borrow from the Agency will therefore be the subject of a separate report to the Board.

Short-term and variable rate loans: These loans leave the Authority exposed to the risk of short-term interest rate rises and are therefore subject to the interest rate exposure limits in the treasury management indicators below. Financial derivatives may be used to manage this interest rate risk (see section below).

Debt rescheduling: 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 in the future 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.

Treasury Investment Strategy

The Authority holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. In the past 12 months, the Authority's treasury investment balance has ranged between £~~160m~~161m and £~~260million~~236million, and levels are expected to be subject to the drawdown of funds to support the delivery of the Combined Authority's priorities and objectives as set out in the Business Plan and the Medium-Term Financial Plan.

Objectives: The CIPFA Code requires the Authority to invest its treasury funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Authority's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income. Where balances are expected to be invested for more than one year, the Authority will aim to achieve a total return that is equal or higher than the prevailing rate of inflation, in order to maintain the spending power of the sum invested.

Negative interest rates: ~~If~~The COVID-19 pandemic has increased the ~~UK enters into a recession in 2020/21, there is a small chance~~risk that the Bank of England ~~could~~will set its Bank Rate at or below zero, which is likely to feed through to negative interest rates on all low risk, short-term investment options. ~~This situation already exists in many other European countries.~~Since investments cannot pay negative income, negative rates will be applied by reducing the value of investments. In this event, security will be measured as receiving the contractually agreed amount at maturity, even though this may be less than the amount originally invested.

Strategy: Given the increasing risk and very low returns from short-term unsecured bank investments, the Authority will continue ~~-~~to diversify into more secure and/or higher yielding asset classes during ~~2020/21. A small~~2021/22. Due to current liquidity requirements, an increasing proportion of the Authority's surplus cash is currently invested in short-term unsecured bank deposits, and money market funds.

Approved counterparties: The Authority may invest its surplus funds with any of the counterparty types in table ~~3~~2 below, subject to the cash limits (per counterparty) and the time limits shown.

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Table ~~3: Approved~~2: Treasury investment counterparties and limits

~~Credit rating~~Sector	~~Banks unsecured~~Time limit	~~Banks secured~~Counterparty limit	~~Government~~ Sector limit	~~Corporates~~	~~Registered Providers~~
The UK ~~Govt~~Government	50 years~~n/a~~ ~~n/a~~	~~£~~Unlimited ~~50 years~~	n/a	~~n/a~~	
~~AAA~~Local authorities & other government entities	25~~£15m~~ ~~5~~ years	£25m ~~20 years~~	~~£25m~~ Unlimited~~50 years~~	~~£15m 20 years~~	~~£15m 20 years~~
~~AA+~~Secured investments *	~~£15m~~ ~~5~~25 years	£25m ~~10 years~~	~~£25m 25 years~~Unlimited	~~£15m 10 years~~	~~£15m 10 years~~
~~AA~~Banks (unsecured) *	13 months ~~£15m 4 years~~ ~~£25m 5 years~~ ~~£25m 15 years~~	£15m ~~5 years~~	~~£15m 10 years~~Unlimited		
~~AA-~~Building societies (unsecured) *	13 months	£15m ~~3 years~~	£25m ~~4 years~~	~~£25m 10 years~~ ~~£15m 4 years~~	~~£15m 10 years~~
~~A+~~Registered providers (unsecured) * ~~£15m 2 years~~ ~~£25m 3 years~~	~~£25m~~ 5 years	£15m ~~3 years~~	£~~15m 5 years~~50m		
~~A~~Money market funds *	~~£15m~~ n/a~~13 months~~	£25m ~~2 years~~	~~£25m 5 years~~Unlimited	~~£15m 2 years~~	~~£15m 5 years~~
~~A-~~Strategic pooled funds	~~£15m 6 months~~n/a	£25m ~~13 months~~	£~~25m 5 years~~100m	~~£15m 13 months~~	~~£15m 5 years~~
~~None~~Real estate investment trusts ~~£1m 6 months~~	n/a	£25m ~~25 years~~	£~~10m 5 years~~50m	~~£15m 5 years~~	
~~Pooled funds and real estate investment trusts~~Other investments *	5 years	£15m	£25m~~ per fund or trust~~		

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Minimum Credit rating: ~~Investment limits are set by reference to~~Treasury investments in the sectors marked with an asterisk will only be made with entities whose lowest published long-term credit rating ~~from a selection of external rating agencies.~~is no lower than [A-]. 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.

~~Banks unsecured:~~For entities without published credit ratings, investments may be made where external advice indicates the entity to be of similar credit quality.

Government: Loans, bonds and bills issued or guaranteed by national governments, regional and local authorities and multilateral development banks. These investments are not subject to bail-in, and there is generally a lower risk of insolvency, although they are not zero risk. Investments with the UK Central Government are deemed to be zero credit risk due to its ability to create additional currency and therefore may be made in unlimited amounts for up to 50 years.

Secured investments: Investments secured on the borrower's assets, which limits the potential losses in the event of insolvency. The amount and quality of the security will be a key factor in the investment decision. Covered bonds and reverse repurchase agreements with banks and building societies are exempt from bail-in. Where there is no investment specific credit rating, but the collateral upon which the investment is secured has a credit rating, the higher of the collateral credit rating and the counterparty credit rating will be used. The combined secured and unsecured investments with any one counterparty will not exceed the cash limit for secured investments.

Banks and building societies (unsecured): Accounts, deposits, certificates of deposit and senior unsecured bonds with banks and building societies, other than multilateral development banks. These investments are subject to the risk of credit loss via a bail-in should the regulator determine that the bank is failing or likely to fail. See below for arrangements relating to operational bank accounts.

~~**Banks secured:** Covered bonds, reverse repurchase agreements and other collateralised arrangements with banks and building societies. These investments are secured on the bank's assets, which limits the potential losses in the unlikely event of insolvency, and means that they are exempt from bail-in. Where there is no investment specific credit rating, but the collateral upon which the investment is secured has a credit rating, the higher of the collateral credit rating and the counterparty credit rating will be used to determine cash and time limits. The combined secured and unsecured investments in any one bank will not exceed the cash limit for secured investments.~~

~~**Government:** Loans, bonds and bills issued or guaranteed by national governments, regional and local authorities and multilateral development banks. These investments are not subject to bail-in, and there is generally a lower risk of insolvency, although they are not zero risk. Investments with the UK Central Government may be made in unlimited amounts for up to 50 years.~~

~~**Corporates:** Loans, bonds and commercial paper issued by companies other than banks and registered providers. These investments are not subject to bail-in, but are exposed to the risk of the company going insolvent. Loans to unrated companies will only be made either following an external credit assessment or to a maximum of £10m per company as part of a diversified pool in order to spread the risk widely.~~

Registered providers~~:~~ (unsecured): Loans to, and bonds issued ~~by,~~or guaranteed by~~ or secured on the assets of~~ registered providers of social housing and registered social landlords, formerly known as housing associations. These bodies are~~ tightly~~ regulated by the Regulator of Social Housing (in England), the Scottish Housing Regulator, the Welsh Government and the Department for Communities (in Northern

Ireland). As providers of public services, they retain the likelihood of receiving government support if needed.

Money market funds: ~~,~~Pooled funds~~: Shares~~ that offer same-day or ~~units in diversified investment vehicles consisting of the any of the above investment types, plus equity shares~~short notice liquidity and ~~property. These funds~~very low or no price volatility by investing in short-term money markets. They have the advantage over bank accounts 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.~~small fee. Although no sector limit applies to money market funds, the Authority will take care to diversify its liquid investments over a variety of providers to ensure access to cash at all times..

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Strategic pooled funds: Bond, equity and property funds that 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.

Real estate investment trusts: Shares in companies that invest mainly in real estate and pay the majority of their rental income to investors in a similar manner to pooled property funds. As with property funds, REITs offer enhanced returns over the longer term, but are more volatile especially as the share price reflects changing demand for the shares as well as changes in the value of the underlying properties. ~~Investments in REIT shares cannot be withdrawn but can be sold on the stock market to another investor.~~

Other investments: This category covers treasury investments not listed above, for example unsecured corporate bonds and company loans. Non-bank companies cannot be bailed-in but can become insolvent placing the Authority's investment at risk.

Operational bank accounts: The Authority may incur operational exposures, for example though current accounts, collection accounts and merchant acquiring services, to any UK bank with credit ratings no lower than BBB- and with assets greater than £25 billion. These are not classed as investments, but are still subject to the risk of a bank bail-in, and balances will therefore be kept below £25m per bank. The Bank of England has stated that in the event of failure, banks with assets greater than £25 billion are more likely to be bailed-in than made insolvent, increasing the chance of the Authority maintaining operational continuity.

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. The credit rating agencies in current use are listed in the Treasury Management Practices document. Where an entity has its credit rating downgraded so that it fails to meet the approved investment criteria then:

- no new investments will be made,
- any existing investments that can be recalled or sold at no cost will be, and
- full consideration will be given to the recall or sale of all other existing investments with the affected counterparty.

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

Other information on the security of investments: The Authority understands that credit ratings are good, but not perfect, predictors of investment default. Full regard will therefore be given to other available information on the credit quality of the organisations in which it invests, including credit default swap prices, financial statements, information on potential government support, reports in the quality financial press and analysis and advice from the Authority's treasury management adviser. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may otherwise meet the above criteria.

When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008 and ~~2011~~2020, 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~~returns to fall but will protect the principal sum invested.

Investment limits: In order to minimise the risk of a single default against available reserves, the maximum that will be lent to any one organisation (other than the UK Government) will be £25m. A group of ~~banks~~entities under the same ownership will be treated as a single organisation for limit purposes.

Credit risk exposures arising from non-treasury investments, financial derivatives and balances greater than £25m in operational bank accounts would be taken account of against the relevant investment limits when making treasury management investments, but the limits in this strategy do not apply to service investments.

Limits will also be placed on fund managers, investments in brokers' nominee accounts, foreign countries and industry sectors as below. Investments in pooled funds and multilateral development banks do not count against the limit for any single foreign country, since the risk is diversified over many countries.

Table 4: Investment limits

	Cash limit
~~Any single organisation, except the UK Central Government~~	~~£25m each~~
~~UK Central Government~~	~~unlimited~~
~~Any group of organisations under the same ownership~~	~~£25m per group~~
Any group of pooled funds under the same management	£50m per manager
Negotiable instruments held in a broker's nominee account	£50m per broker
Foreign countries	£25m per country
~~Registered providers and registered social landlords~~	~~£50m in total~~
~~Unsecured investments with building societies~~	~~£25m in total~~
~~Loans to unrated corporates~~	~~£40m in total~~

~~Money market funds~~	~~£100m in total~~
~~Real estate investment trusts~~	~~£50m in total~~

~~**'Top Up' Fund**~~

~~The Investment Strategy sets out provision for the Combined Authority to make 'service investments' from the £40m 'revolving' Housing Fund and the Local Growth Fund. Whilst the revolving £40m fund derives from the £100m grant funding for affordable housing, the 'top up' fund is 'treasury' cash, being earmarked for other projects within the Medium Term Financial Plan (MTFP), but available for investment until such time as they are required to be drawn down to fund delivery. The availability of these balances is identified within the Authority's cashflow forecast. The criteria for the use of these balances will be consistent with the fundamental treasury management concepts of 'Security' first, then 'Liquidity' and then 'Return'.~~

~~**Security:** The main risk when making service loans is that the borrower will be unable to repay the principal lent and/or the interest due. In order to limit this risk and ensure that total exposure to service loans remains proportionate to the cash balances available, upper limits on outstanding loans made from the 'top up' fund are limited to £40m in total and £10m to any individual borrower.~~

~~**Risk assessment:** The Authority would assess the risk of loss before entering into and whilst holding service loans. Loans are subject to the following risk assessment and mitigating actions:~~

1) ~~An appropriate level of due diligence, to include the use of external advisors where appropriate.~~
2) ~~An appropriate loan period and timing of repayments and within balances available as determined by the Combined Authority's Cashflow forecast.~~
3) ~~The calculation of an interest rate that would represent 'value for money' be of 'no detriment' to the Combined Authority and to minimise the risk of State Aid challenge.~~
4) ~~Approval being subject to a business case, due diligence and loan agreement to the satisfaction of the Chief Executive, Monitoring Officer and Chief Finance Officer.~~
5) ~~The business case would be reviewed to include focus on:~~
    a. ~~Impact of existing loans and charges on assets~~
    b. ~~Accuracy and reasonableness of Cashflow and profit forecasts~~
    c. ~~Ambition of future sales targets and income to repay loan~~
    d. ~~Provisions/allowances for contingency, inflation~~
    e. ~~Review of credit worthiness of business and collateralisation of loan~~
6) ~~First legal charge over land and assets~~
7) ~~Regular review and valuation of the assets~~
8) ~~Drawdown subject to a gateway process~~
9) ~~Consideration of options of parent company guarantees~~
10) ~~Consideration of obligations of S106 agreements~~

~~All loans are subject to approval by the Combined Authority Board.~~

Liquidity management: The Authority uses cash flow forecasting to determine the maximum period for which funds may prudently be committed. The forecast is compiled on a prudent basis to minimise the risk of the Authority being forced to borrow on unfavourable terms to meet its financial commitments. Limits on long-term investments are set by reference to the Authority's medium-term financial plan and cash flow forecast.

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Treasury Management Indicators

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

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

Credit risk indicator	Target
Portfolio average credit rating	6 (A)

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Liquidity: The Authority has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet ~~unexpected~~ payments within a rolling three month period, without additional borrowing.

Liquidity risk indicator	Target
Total cash available within 3 months	£50m

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Interest rate exposures: This indicator is set to control the Authority's exposure to interest rate risk:

Interest rate risk indicator	Limit
Upper limit on one-year revenue impact of a 1% rise in interest rates	£~~1m~~1.5m
Upper limit on one-year revenue impact of a 1% fall in interest rates	£~~1m~~1.5m

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

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 a year (excluding loans): The purpose of this indicator is to control the Authority's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the long-term principal sum invested to final maturities beyond the period end will be:

Price risk indicator	~~2020/21~~2021/22	2022/23~~2021/22~~	2023/24~~2022/23~~
Limit on principal invested beyond year end	£160m	£50m	£50m

Related Matters

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

Financial Derivatives: Local authorities have previously made use of financial derivatives embedded into loans and investments both to reduce interest rate risk (e.g. interest rate collars and forward deals) and to reduce costs or increase income at the expense of greater risk (e.g. LOBO loans and callable deposits). The general power of competence in Section ~~1~~113A of the ~~*Localism*~~Local Democracy, Economic Development and Construction, Act ~~*2011*~~2009, removes much of the uncertainty over ~~local~~combined authorities' use of standalone financial derivatives (i.e. those that are not embedded into a loan or investment).

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The Authority will only use standalone financial derivatives (such as swaps, forwards, futures and options) where they can be clearly demonstrated to reduce the overall level of the financial risks that the Authority is exposed to. Additional risks presented, such as credit exposure to derivative counterparties, will be taken into account when determining the overall level of risk. Embedded derivatives, including those present in pooled funds and forward starting transactions, will not be subject to this policy, although the risks they present will be managed in line with the overall treasury risk management strategy.

Financial derivative transactions may be arranged with any organisation that meets the approved investment criteria~~. The current value of any amount due from a derivative counterparty~~, assessed using the appropriate credit rating for derivative exposures. An allowance for credit risk calculated using the methodology in the Treasury Management Practices document will count against the counterparty credit limit and the relevant foreign country limit.

In line with the CIPFA Code, the Authority will seek external advice and will consider that advice before entering into financial derivatives to ensure that it fully understands the implications.

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

Financial Implications

The budget for investment income in ~~2020/21~~2021/22 is £~~1.02~~0.23 million, based on the expected investment portfolio. ~~The~~There is no budget for debt interest paid in ~~2020/21 is £2.56 million, based on the maximum debt cap available to the authority calculated at the current PWLB 25 year~~2021/22 as no borrowing ~~rate.~~is expected.

Where investment income exceeds budget, e.g. from higher risk investments including pooled funds, or debt interest paid falls below budget, e.g. from cheap short-term borrowing, then consideration will be given to transferring a portion of the revenue savings will be transferred to a treasury management reserve to cover the risk of capital losses or higher interest rates payable in future years.

Other Options Considered

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

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

Invest in a wider range of counterparties and/or for longer times	Interest income will be higher	Increased risk of losses from credit related defaults, but any such losses may be smaller
Borrow additional sums at long-term fixed interest rates	Debt interest costs will rise; this is unlikely to be offset by higher investment income	Higher investment balance leading to a higher impact in the event of a default; however long-term interest costs may be more certain
Borrow short-term or variable loans instead of long-term fixed rates	Debt interest costs will initially be lower	Increases in debt interest costs will be broadly offset by rising investment income in the medium term, but long-term costs may be less certain
Reduce level of borrowing	Saving on debt interest is likely to exceed lost investment income	Reduced investment balance leading to a lower impact in the event of a default; however long-term interest costs may be less certain

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Appendix ~~B~~A - Existing Investment & Debt Portfolio Position

	~~29 Feb~~31 De 2020 **Actual Portfolio** **£m**	**Average Rate** **%**
External borrowing:		
Public Works Loan Board	**0**	
Local authorities	**0**	
LOBO loans from banks	**0**	
Other loans	**0**	
Total external borrowing	**0**	
Total gross external debt	0	
Treasury investments:		
Banks & building societies (unsecured)	~~6.2~~	0.~~55~~01
Government (incl. local authorities)	~~154.~~0.1	0.~~86~~39
Money Market Funds	~~10~~147.4 40.0	0.~~72~~02
Total treasury investments	~~170.2~~187.5	0.~~84~~31
Net debt	(~~170.2~~187.5)	