Audit, Risk & Assurance Committee

Date	18 January 2022
Report title	2022/23 Treasury Management Policy, Strategy and Practices.
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Report has been considered by	Not Applicable

Recommendation(s) for action or decision:

ARAC is recommended to:

1 Review and endorse the draft 2022/23 Treasury Management Policy Statement (TMPS) (Section 2 of this report) for onward approval by WMCA Board in February 2022.

2 Review and endorse the Draft 2022/23 Treasury Management Strategy (TMS) (Appendix 1) for onward approval by WMCA Board in February 2022.

3 Note and agree the arrangements for ensuring Treasury Management Practices are adequately maintained (Section 4).

1. Purpose

1.1 WMCA as a public body is required to have regard to the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2017 Edition (the CIPFA Code) in discharging all its financial responsibilities. At the time of writing this report an updated Code (2021 edition) is currently due for publication following consultation. CIPFA has indicated that it will have a 'soft launch' and therefore authorities have until March 2023 to adopt the Code and implement its recommendations. A further report noting changes to the Code for approval will be presented to both ARAC and Board at the earliest opportunity during financial year 2022/23.

1.2 In relation to Treasury Management, the Code states that the organisation delegates responsibility for the implementation and regular monitoring of its Treasury Management Policies to Audit, Risk & Assurance Committee (as an independent scrutiny function). Officers are subsequently obliged to operate within the Treasury Management Strategy parameters as set and monitored by the scrutiny function.

1.3 ARAC members received an overview of the regulatory environment and WMCA's Treasury Management Practices in January 2021 and a subsequent presentation/training session will be arranged with our treasury advisors, Link Treasury Services Ltd, in the early part of 2022 to coincide with the publication of the revised Code.

1.4 The report sets out WMCA's Treasury Management Policy Statement (below) and Treasury Management Strategy (Appendix 1) for review and endorsement by ARAC prior to submission to WMCA Board in February 2022.

2 Treasury Management Policy Statement

2.1 The CIPFA Code of Practice on Treasury Management in the Public Services (the Code) was revised in December 2017. As mentioned in Section 1 a further update is planned for publication in late 2021 for adoption prior to 31st March 2023. The Code requires the setting out of the responsibilities and duties of members and officers, allowing a framework for reporting and decision making on all aspects of treasury management. This Authority had adopted the original Code and has similarly adopted the revised 2017 Code in December 2018. The Code recommends the creation and maintenance of:

- A Treasury Management Policy Statement, stating the policies and objectives of its treasury management activities,
- Suitable Treasury Management Practices setting out the manner in which the organisation will seek to achieve those policies and objectives and prescribing how it will manage and control those activities.

2.2 The 2017 CIPFA Code recommends that authorities should:

- Put in place formal and comprehensive objectives, policies and practices, strategies and reporting arrangements for the effective management and control of their treasury management activities.

- Policies and practices make clear that the effective management and control of risk are prime objectives of their treasury management activities and that responsibility for these lies clearly within their organisations. Their appetite for risk should form part of their annual strategy, including any use of financial instruments for the prudent management of those risks, and should ensure that priority is given to security and portfolio liquidity when investing treasury management funds.

- Acknowledge that the pursuit of value for money in treasury management, and the use of suitable performance measures, are valid and important tools for responsible organisations to employ in support of their business and service objectives; and that within the context of effective risk management, their treasury management policies and practices should reflect this.

2.3 In order to achieve the above, the Authority will do the following:

- WMCA will create and maintain:

    - A Treasury Management Policy Statement, stating polices, objectives and approach to risk management of its treasury management activities.

    - Suitable Treasury Management Practices (TMPs), setting out the manner in which the organisation will seek to achieve those policies and objectives, and prescribing how it will manage and control those activities.

    - The contents of the policy statement and TMPs by following the recommendations contained in section 6 and 7 of the Code, subject only to amendment where necessary to reflect the WMCA's particular circumstances.

- WMCA Board will receive, as a minimum, an Annual Treasury Management Strategy, a mid-year review and an annual outturn report after its close, in the form prescribed in its TMPs.

- WMCA delegates responsibility for the implementation and monitoring of its treasury management policies and practices to the Treasury Management Group (TMG), and for the execution and administration of treasury management decisions to the Director of Finance, who will act in accordance with the WMCA's policy statement and TMPs and CIPFA' Standard of Professional Practice on Treasury Management.

2.4 The draft 2022/23 Treasury Management Policy Statement is shown below for review and endorsement by ARAC.

2022 / 2023 Treasury Management Policy Statement

WMCA's Treasury Management Policy Statement defines the policies and objectives of its treasury management activities, as follows:

(1) Treasury management activities are defined as the management of the Authority's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and pursuit of optimum performance consistent with those risks.

(2) WMCA regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their implications for WMCA, and any financial instruments entered into to manage these risks.

(3) WMCA acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving value for money in treasury management, and to employ suitable comprehensive performance measurement techniques, within the context of effective risk management.

3. WMCA 2022/23 Treasury Management Strategy

3.1 Following on from the Treasury Management Policy Statement above, the Treasury Management Strategy defines how the policy will be adhered to and provides a framework for WMCA treasury practitioners to operate within.

3.2 ARAC are requested to review and endorse the Draft 2022/23 Treasury Management Strategy which features as Appendix 1 to this report; for onward approval by WMCA Board in February 2022.

4. Treasury Management Practices

4.1 Finally, recommendation 3 within this report requests that ARAC note and agree the arrangements for ensuring Treasury Management Practices (TMP) are adequately maintained. The revised 2017 CIPFA Code recommends that authorities should put in place formal and comprehensive objectives, policies and practices, strategies and reporting arrangements for the effective management and control of their treasury management activities.

4.2 WMCA maintain (TMPs) in line with the relevant guidance. These practices set out the manner in which the organisation will seek to achieve the policies and objectives and documents how it will manage and control those activities.

4.3 There are currently twelve individual practices which cover:

- Risk management;
- Performance measurement;
- Decision-making and analysis;
- Approved instruments, methods and techniques;
- Organisation, clarity and segregation of responsibilities and dealing;
- Reporting requirements and management information arrangements;
- Budgeting, accounting and audit arrangements;
- Cash and cash flow management;
- Money laundering;
- Training and qualifications;
- Use of external service providers;
- Corporate governance.

4.4 Other Schedules supporting these practices and other documents held at an operational level specify the systems and routines to be employed and the records to be maintained in fulfilling WMCA treasury functions (Treasury Management Operational Procedures).

4.5 ARAC are requested to note and agree the approach:

- Which delegates responsibility for the implementation and monitoring of its treasury management policies and practices to TMG (consisting of the WMCA Finance Director, The WMCA Head of Financial Planning, the Lead Treasury Accountant and other WMCA technical experts as required)
- Which delegates the execution and administration of treasury management decisions to the Director of Finance, who will act in accordance with the WMCA's policy statement and TMPs and CIPFA' Standard of Professional Practice on Treasury Management.

4.6 ARAC will receive independent assurance that the TMPs are fit for purpose and operating effectively from the annual Internal Audit of key financial systems. However, the actual TMPs are also available for ARAC review upon request.

APPENDIX 1

Treasury Management Strategy 2022/23

Introduction

Treasury management is the management of WMCA's cash flows, borrowing and investments, and the associated risks. WMCA 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 WMCA's prudent financial management.

Treasury risk management at WMCA 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 WMCA to approve a treasury management strategy before the start of each financial year. At the time of writing this report an updated Code (2021 edition) is currently due for publication following consultation. CIPFA has indicated that it will have a 'soft launch' and therefore authorities have until March 2023 to adopt the Code and implement its recommendations. A further report noting changes to the Code for approval will be presented to both ARAC and Board at the earliest opportunity during financial year 2022/23.

This report fulfils WMCA's legal obligation under the Local Government Act 2003 to have regard to the CIPFA Code.

The strategy for 2022/23 covers the following main areas:

- the current treasury position;
- prospects for interest rates;
- the borrowing strategy;
- debt rescheduling;
- policy on borrowing in advance of need;
- the investment strategy and creditworthiness policy;
- the policy on use of external service providers; and
- treasury indicators which limit the treasury risk and activities of the Council.

These elements cover the requirements of the Local Government Act 2003, DLUHC Investment Guidance, and the CIPFA Treasury Management Code.

Current Treasury Position

The overall treasury management portfolio as at 31st March 2021 and for the position as at 31st December 2021 are shown below for both borrowing and investments.

Table 1 Treasury Management Portfolio

	Actual	Actual	Current	Current
	Mar 21	Mar 21	Dec 21	Dec 21
Treasury Investments	£m	%	£m	%
Banks	48.97	20	120.00	28
Local Authorities	135.70	55	293.00	68
Housing Associations			10.00	2
Money Market Funds	60.00	25	5.00	1

Total Managed In House	**244.67**	**100**	**428.00**	**99**
Property Funds / REITs	-	-	5.10	1
Total Managed Externally	**-**	**-**	**5.10**	**1**
Total Treasury Investments	**244.67**	**100**	**433.10**	**100**
Treasury External Borrowing				
PWLB	(108.43)	87	(263.24)	94
Banks	(10.00)	8	(10.00)	4
Transferred Debt	(5.59)	5	(5.59)	2
Total External Borrowing	**(124.02)**	**100**	**(278.83)**	**100**
Net treasury investments/(borrowing)	**120.65**		**154.27**	

The Council's forward projections for borrowing are summarised below. The table shows the actual external debt against the underlying capital borrowing need (the Capital Financing Requirement - CFR), highlighting any over or under borrowing.

Table 2: WMCA Gross External Debt vs. CFR

£M	2021/22	2022/23	2023/24	2024/25	2025/26	2026/27
Opening External Debt	124	279	404	739	784	804
New Borrowing	155	125	335	45	20	0
Forecast Closing External Debt	**279**	**404**	**739**	**784**	**804**	**804**
Capital Financing Requirement (CFR)	634	871	1,073	1,110	1,105	1,076
Under Borrowing	355	467	334	326	301	272

WMCA has an increasing CFR – rising from a forecast £634m at the end of 2021/22 to £1,110m at the end of 2024/25 - due to its capital programme, mostly driven by the delivery of the Investment Programme. The Authority is currently 'under borrowed', meaning that internal cash-backed resources such as balances, reserves, and working capital (predominantly capital grants received in advance) can be deployed to offset external borrowing. Working capital levels have been above £400m for much of 2020/21 as new grants received in advance of expenditure have been received. Short-term interest rates are currently much lower than long-term rates and forecast to remain so for a considerable period. This makes it more cost effective in the short-term to continue to use internal resources and to borrow externally only when required. However, decreasing values of investments over time, as these capital grants received in advance are spent, will require WMCA to borrow up to £680m (net of investment income) over the forecast period.

CIPFA's Prudential Code for Capital Finance in Local Authorities recommends that WMCA's total debt should be lower than its highest forecast CFR over the next three years. Table 2 shows that WMCA expects to comply with this recommendation during 2022/23 to 2024/25.

Prospects for Interest Rates

The Council has appointed Link Treasury Services Ltd as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. Link provided the following forecasts on 20th December 2021. PWLB forecasts are for certainty rates, 20 basis points below PWLB standard rates, to which WMCA has agreed access.

	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25
BANK RATE	0.25	0.25	0.50	0.50	0.50	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.25
3 month ave earnings	0.30	0.40	0.50	0.50	0.50	0.60	0.80	0.90	1.00	1.00	1.00	1.00	1.00	1.00
6 month ave earnings	0.40	0.50	0.60	0.60	0.70	0.80	0.90	1.00	1.10	1.10	1.10	1.10	1.10	1.10
12 month ave earnings	0.50	0.60	0.70	0.70	0.80	0.90	1.00	1.10	1.20	1.20	1.20	1.20	1.20	1.20
5 yr PWLB	1.50	1.50	1.60	1.60	1.70	1.70	1.70	1.80	1.80	1.80	1.90	1.90	2.00	2.00
10 yr PWLB	1.80	1.90	1.90	2.00	2.00	2.10	2.10	2.20	2.20	2.20	2.30	2.30	2.30	2.40
25 yr PWLB	2.10	2.20	2.30	2.40	2.40	2.40	2.50	2.50	2.60	2.60	2.60	2.60	2.70	2.70
50 yr PWLB	1.90	2.00	2.10	2.20	2.20	2.20	2.30	2.30	2.40	2.40	2.40	2.40	2.50	2.50

The coronavirus outbreak has done huge economic damage to the UK and to economies around the world. After the Bank of England took emergency action in March 2020 to cut Bank Rate to 0.10%, it left Bank Rate unchanged at its subsequent meetings until December 2021.

As shown in the forecast table above, the forecast for Bank Rate now includes four increases, one in quarter 2 of 2022 to 0.50%, quarter 1 of 2023 to 0.75%, quarter 1 of 2024 to 1.00% and, finally, one in quarter 1 of 2025 to 1.25%.

The level and pace of the change forecast remains modest in comparison with recoveries from historical recessions. Minutes from recent MPC meetings suggest there has been a marked change in concern over price inflation, particularly relating to gas and electricity. Nonetheless, it should be remembered that the rate cut to 0.10% at the beginning of the pandemic was an emergency measure and taking it away can be seen as a signal of a return to normalisation. In addition, any Bank Rate below 1% remains highly unusual and highly supportive of economic growth.

Borrowing Strategy

As at 31 December 2021 WMCA currently holds £278.8m of loans, an increase of £153.8m on the previous year. The forecast in table 2 shows that WMCA expects to borrow up to £125m in 2022/23. WMCA may also borrow additional sums to pre-fund future years' requirements, providing this does not exceed the authorised limit for borrowing.

Objectives: WMCA'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 WMCA's long term plans change is a secondary objective.

Strategy: WMCA's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. Short-term interest rates are currently much lower than long-term rates and forecast to remain so for a considerable period. It is likely therefore to be more cost effective in the short-term to continue to use internal resources and to borrow a proportion of the debt requirement using short-term loans instead.

By doing so, WMCA can reduce its net borrowing costs (despite foregone investment income) and reduce overall treasury risk. The benefits of 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. Link Treasury Group will assist WMCA with this ‘cost of carry’ and ‘borrow now/borrow later’ analysis. Its output may determine whether WMCA borrows additional sums at long-term fixed rates in 2022/23 with a view to keeping future interest costs low, even if this causes additional cost in the short-term.

WMCA has previously raised the majority of its long-term borrowing from the PWLB, but will consider long-term loans from other sources including banks, pension funds and local authorities, and will also 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 held primarily for yield; the Authority intends to avoid this activity in order to retain its access to PWLB loans. WMCA Finance Directors and their respective treasury teams continue to work collectively also, ensuring the buying power of the region is fully exploited in the capital markets.

It should be noted that following two competitive process during 2019/20 and 2020/21, WMCA were notified by HM Treasury that it would qualify for Infrastructure Rate Funding. This guaranteed WMCA access to debt at 0.40% below the currently published PWLB standard rate levels. £155m of this facility has been utilised in 2021/22 and a further £45m remains available prior to November 2022. Access to this financing together with the use of short-term debt will provide WMCA with a bridge whilst the most competitive sources of long-term finance are identified.

Additionally, WMCA will look to identify suitable 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 and may help to de-risk commercial borrowing models.

In addition, WMCA may borrow using further 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 lending facility (i.e. Public Works Loan Board)
- UK Infrastructure Bank
- 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 West Midlands Local Government 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

Short-term and variable rate loans: These loans leave WMCA exposed to the risk of short-term interest rate rises and are therefore subject to the interest rate exposure limits set out in the treasury management indicators below. Consequently, 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. WMCA may take advantage of this and replace some loans with new loans, or repay loans without replacement, where this is expected to lead to an overall cost saving or a reduction in risk.

Policy on Borrowing In Advance of Need

WMCA will not borrow more than or in advance of its needs purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be within the forward approved Capital Financing Requirement estimates and will be considered carefully to ensure that value for money can be demonstrated and that the Authority can ensure the security of such funds.

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

HM Treasury External Debt Cap

WMCA has acquired approval from HM Treasury and the Dept for Levelling Up, Housing and Communities (DLUHC) to borrow for all of its functions subject to it operating within an agreed external debt cap. The debt cap runs coterminous with the 5-year gateway review period and the caps for 2022/23 and beyond are expected to be finalised with HM Treasury during 2021/22. On the basis it remains unchanged, WMCA do not expect to breach the debt cap during 2022/23 based on the current external debt and projections for the 2020/21 financial year. For information, the existing agreed limit is £1,042 million.

Treasury Investment Strategy

WMCA holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. During 2021/22 WMCA's treasury average monthly investment balance has ranged between £233m and £477m, and similar levels are expected to be maintained throughout parts of 2022/23 largely due to the profile of Government grant receipts in quarter one.

The Council's investment policy has regard to the following: -

- DLUHC's Guidance on Local Government Investments ("the Guidance")
- CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes 2017 ("the Code")
- CIPFA Treasury Management Guidance Notes 2018

Objectives: The CIPFA Code requires WMCA 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. WMCA'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, WMCA will aim to achieve a total return that is equal to or higher than the prevailing rate of inflation, in order to maintain the spending power of the sum invested.

Negative interest rates: The COVID-19 pandemic demonstrated the risk that the Bank of England would set its Bank Rate at or below zero, which in turn would likely feed through to negative interest rates on all low risk, short-term investment options. 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. Whilst WMCA would seek to avoid exposure towards negative interest rates in these circumstances, it must first meet the security and liquidity requirements of all investment holdings.

Strategy: Investments will be made with reference to WMCA core balances and cash flow requirements and the outlook for short-term interest rates (i.e., rates for investments up to 12 months). Greater returns are usually obtainable by investing for longer periods. While most cash balances are required in order to manage the ups and downs of cash flow where cash sums can be identified that could be invested for longer periods, the value to be obtained from longer term investments will be carefully assessed. Given that Bank Rate is forecast to rise incrementally over the investment time horizon consideration will be given to keeping most investments as short term and/or variable. The regular stream of maturing investments brought about by this 'laddering' approach should provide opportunities to consistently improve underlying yield, while still allowing flexibility to adjust if market circumstances alter. This is particularly the case if the MPC do not follow the increasingly more "aggressive" path that markets are continuing to price in.

Investment returns expectations: Based on the current prospects for interest rates appraisal by Link Treasury Services Ltd the suggested budgeted investment earnings rates for returns on investments placed for periods up to about three months during each financial year are as follows:

Average earnings in each year	
2022/23	0.50%
2023/24	0.75%
2024/25	1.00%
2025/26	1.25%
Long term later years	2.00%

For its cash flow generated balances, the Council will seek to utilise its business reserve instant access and notice accounts, money market funds and short-dated deposits, in order to benefit from the compounding of interest.

Business models: Under the IFRS 9 standard, the accounting for certain investments depends on WMCA's "business model" for managing them. WMCA aims to achieve value from its internally managed treasury investments via a business model of collecting the contractual cash flows and therefore, where other criteria are also met, these investments will continue to be accounted for at amortised cost.

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

Table 3: Approved investment counterparties and limits

Sector	Time limit	Counterparty limit	Sector limit
The UK Government	50 years	Unlimited	n/a
Local authorities & other government entities	50 years	Unlimited[1]	Unlimited
Secured investments *	25 years	£20m[1]	Unlimited
Banks (unsecured) *	13 months	£20m[1]	Unlimited
Building societies (unsecured) *	13 months	£20m[1]	£20m
Registered providers (unsecured) *	5 years	£5m	£20m
Money market funds *	n/a	£20m	Unlimited
Strategic pooled funds	n/a	£5m	£10m
Real estate investment trusts	n/a	£5m	£10m
Other investments	5 years	£2m	£10m

<u>This table must be read in conjunction with the following notes.</u>

[1] Normal operating levels will not exceed £10m per counterparty but adequate headroom has been provided to accommodate potential peak cashflow requirements. The Combined Authority will look to keep an even spread of investments across counterparties to minimize exposure to defaults.

*** Minimum credit rating**: Treasury investments in the sectors marked with an asterisk will only be made with entities whose lowest published long-term credit rating 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 considered.

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 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.

Registered providers (unsecured): Loans to, and bonds issued or guaranteed by, registered providers of social housing or registered social landlords, formerly known as housing associations. These bodies are 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 that offer same-day or short notice liquidity and 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 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.

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.

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: WMCA may incur operational exposures, for example though current accounts, 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 £1m 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 WMCA maintaining operational continuity.

Risk assessment and credit ratings: Credit ratings are obtained and monitored by WMCA'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 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: WMCA 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. 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 2020, this is not generally reflected in credit ratings, but can be seen in other market measures. In these circumstances, WMCA 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.

Investment limits: In order that WMCA's reserves will not be put at significant risk in the case of a single default, the maximum that will be lent to any one organisation (other than the UK Government) will be £20 million. A group of banks under the same ownership will be treated as a single organisation for limit purposes. Limits are also placed on fund managers, investments in brokers' nominee accounts and foreign countries 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: Additional Investment limits

	Cash Limit
Any group of pooled funds under the same management	£20m per manager
Negotiable instruments held in a broker's nominee account	£20m per broker
Foreign countries	£5m per country

Liquidity management: WMCA utilises short, medium-term, and long-term cash flow forecasts 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 WMCA being forced to borrow on unfavourable terms to meet its financial commitments. Limits on long-term investments are set by reference to WMCA's medium-term financial plan and cash flow forecast.

Commercial Investment Funds

WMCA operate commercial loan funds on behalf of the Constituent Local Authorities. The investment funds limit is £210m and provide loans at a commercial rate to developers where the more traditional financial institutions are not willing to lend on agreeable terms. The primary objective of the investment funds is to stimulate economic regeneration. The loans are held on the WMCA balance sheet under standard accounting regulations and as at December 2021, the cumulative value of loan commitments approved by WMCA totals £166.4m (including £56m of loans which have since been repaid). The value of loans drawn and earning interest as at December 2021 is £20.4m.

Whilst these developers do not have a credit rating in the traditional sense, WMCA employ fund managers West Midlands Development Capital to ensure adequate due diligence is undertaken and that each loan agreement will be adequately secured, usually on the land / buildings underpinning the requirement. Furthermore, each loan agreement requires approval by Investment Board and protections around concentration risk (i.e. limiting the cumulative value of loans to any one developer) were reviewed and approved by WMCA Investment Board in July 2019.

Use of External Providers

£5m of WMCA funds is externally managed on a pooled basis by CCLA Local Authority Property Fund and Fundamentum Social Housing Real Estate Investment Trust (REIT)

The Authority fully appreciates the importance of monitoring the activity and resultant performance of its appointed external fund manager(s). In order to aid this assessment, the Authority is provided with a suite of regular reporting from its manager(s). This includes:

- Monthly valuation updates and factsheets;
- Quarterly dividend statements;
- Annual reports / conference places; and
- Access to online fund reporting sites.

In addition to formal reports, the Council also meets with representatives of the fund managers on a semi-annual basis. These meetings allow for additional scrutiny of the manager's activity as well as discussions on the outlook for the fund as well as wider markets.

Treasury Management Indicators

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

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

Credit risk indicator	Target
Portfolio average credit	A minus

Liquidity: WMCA 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	£20m (min)

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

Refinancing rate risk indicator	Upper Limit	Lower limit
Under 12 months	75%	0%
12 months and within 24 months	50%	0%
24 months and within 5 years	70%	0%
5 years and within 10 years	70%	0%
10 years and above	70%	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 a year: The purpose of this indicator is to control WMCA'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	2022/23	2023/24	2024/25
Limit on principal invested longer than a year	£10m	£10m	£10m

<u>Related Matters</u>

The CIPFA Code requires WMCA 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 of the Localism Act 2011 removes much of the uncertainty over local authorities' use of standalone financial derivatives (i.e. those that are not embedded into a loan or investment).

WMCA 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 WMCA 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 will count against the counterparty credit limit and the relevant foreign country limit.

In line with the CIPFA Code, WMCA 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: WMCA has retained professional client status with its providers of financial services, including advisers, banks, brokers and fund managers, allowing it access to a greater range of services but without the greater regulatory protections afforded to individuals and small companies. Given the size and range of WMCA's treasury management activities, the Section 151 Officer considers this to be the most appropriate status.

Investment Training The needs of the Authority's treasury management staff for training in investment management are assessed every twelve months as part of the staff appraisal process, and additionally when the responsibilities of individual members of staff change. Staff regularly attend training courses, seminars and conferences provided by Link Treasury Services Ltd and CIPFA. Relevant staff are also encouraged to study professional qualifications from CIPFA, the Association of Corporate Treasurers and other appropriate organisations.