NORTH
OF TYNE
COMBINED
AUTHORITY

Overview and Scrutiny Committee – Extra Ordinary Meeting

Wednesday 18 December 2019 at 3.00 pm
Meeting to be held: Mansion House, Fernwood Road, Newcastle upon Tyne NE2 1TJ

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AGENDA

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NORTH OF TYNE COMBINED AUTHORITY

Overview and Scrutiny Committee

18 December 2019

Subject:	**2020-2024 Draft Financial Plan and Budget**
Report of:	**Janice Gillespie** **Interim Section 73 Officer**

Report Summary

The purpose of this report is to present to the Overview and Scrutiny Committee the 2020-2024 Draft Financial Plan and Budget for the North of Tyne Combined Authority.

Recommendations

The Overview and Scrutiny Committee is recommended to:

1) Note the 2020-2024 Draft Financial Plan and Budget (Appendix 1);
2) Make any comments and recommendations to the Interim Section 73 Officer in relation to the draft 2020-2024 Draft Financial Plan and Budget;
3) Indicate which areas of the draft 2020-2024 Draft Financial Plan and Budget the Committee will require further information on at its budget workshop on 15 January 2020; and
4) Agree to grant authority to the Chair of the Committee, in consultation with the Vice Chair, to approve any recommendations in relation to the draft budget proposals the committee may have after their budget workshop for submission to Cabinet on 28 January 2020.

1. Introduction

1.1. At its 8 October 2019 meeting the Overview and Scrutiny Committee received a report on the 2020-2024 Financial Planning and Budget Process which provided information in relation to the proposed 2020-24 Financial Planning and Budget process, including the development of a Medium-Term Financial Strategy (MTFS), the development of the detailed budgets for 2020/21 and the timetable for the setting of the budget.

1.2. Cabinet will have met on 17 December 2019 to consider and agree the draft budget proposals for the authority. As set out in Part 3.2 of the Constitution, these budget proposals and accompanying information are then referred to the Overview and Scrutiny Committee for their comment.

1.3. Attached at appendix 1 are the draft budget proposals as presented to Cabinet at their meeting held on 17 December 2019. Should Cabinet make any changes to these proposals they will be reported to the Committee at its meeting on the 18 December 2019.

1.4. The Overview and Scrutiny Committee agreed in July that as part of its work programme it would hold a workshop in January 2020 to consider in detail the Authority's draft budget proposals and recommendations to Cabinet. This workshop is taking place on Wednesday 15 January 2020 at 9.30am.

1.5. Any recommendations/observations the Committee makes on the budget proposals after this workshop will be submitted to Cabinet and Cabinet must have regard to any recommendations and/or observations from the Overview and Scrutiny Committee when formulating their final proposals. Cabinet are expected to approve their final budget proposals at a meeting on 28 January 2020.

1.6. Due to the short timeframe between the workshop and the Cabinet meeting, the Committee is recommended to agree to grant authority to the Chair and Vice Chair of the Committee to approve the final wording of any recommendations in relation to the budget proposals the Committee may have after the budget workshop for submission to Cabinet on 28 January 2020. The Committee will have agreed the recommendations in principle at the workshop.

2. Appendices

Appendix 1 2020-2024 Draft Financial Plan and Budget Report to Cabinet, 17 December 2019.

3. Background papers

2020/2024 Financial Planning and Budget Process Report to Cabinet, 26 September 2019.
Overview and Scrutiny Committee Work Programme for 2019/20 Report to Overview and Scrutiny Committee 2 July 2019.
North of Tyne Constitution

4. Contact Officers

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Appendix 1

NORTH OF TYNE COMBINED AUTHORITY

Cabinet

17 December 2019

Subject: NTCA Budget Proposals 2020-2024

Report by: Janice Gillespie, Chief Finance Officer

Report Summary

The purpose of this report is to approve the draft budget for the North of Tyne Combined Authority (NTCA) for 2020-21, and the medium-term financial plan for the period 2020-2021 to 2023-24. Cabinet is recommended to approve the draft budget, which will then be subject to consultation with Overview and Scrutiny Committee.

In developing the draft budget proposals, the Mayor and Cabinet have been clear that NTCA should be a lean, agile, outward-facing organisation, working closely with stakeholders to achieve its goals. The combined authority will continue to draw on the expertise of its three constituent authorities to maximise opportunities for efficiency, including through use of Service Level Agreements for key corporate functions. The authority will also look to maximise funding available through use of the £20m per annum Investment Fund to leverage in additional investment. In addition, delivery of the devolved Adult Education budget commences during 2020-21. There continues to be no additional cost to local taxpayers or local authorities in the current draft budget proposals.

Recommendations

The Cabinet is recommended to:

1. Agree the draft Corporate budget for 2020-21 as set out in Paragraph 1.1, which will then be subject to consultation with the Overview and Scrutiny Committee.

2. Agree the draft Investment Fund as set out in paragraph 1.2, which will then be subject to consultation with the Overview and Scrutiny Committee.

3. Agree the draft Adult Education Budget as set out in paragraph 1.3, which will then be subject to consultation with the Overview and Scrutiny Committee.

4. Agree the draft Treasury Management Strategy 2020-21 as described in paragraph 1.5 and attached at Appendix A which will then be subject to consultation with Overview and Scrutiny Committee.

5. Note that the Transport Levies will be issued on the 15 February in line with 2019-20 arrangements and amounts.

6 Agree to hold the level of reserves set out in paragraph 1.8 and to note that the Chief Finance Officer continues to keep the level of reserves under review as the Authority develops and new information becomes available about the financial risks facing authority arrangements for managing those risks.

1. Background Information, Proposals and Timetable for Implementation

1.1 Draft Corporate Budget

On the 12 March 2019 the authority set a Corporate budget for 2019-20 which established an initial baseline position for the first full financial year of the authority.

Since that time officers have continued to consider the ongoing requirements of the new authority and Table 1 below identifies the proposed core draft budget that is required to operate the Mayoral Combined Authority and how it is to be funded.

Table 1 Draft 2020/21 Budget and 2020-24 Financial Plan

	4-Yr Corp Draft budget - Summary				
	2020-21	**2021-22**	**2022-23**	**2023-24**	**Total**
	£'000	£'000	£'000	£'000	£'000
Expenditure					
Staffing	2,132	2,171	2,173	2,183	8,659
Mayor's Office	268	273	277	281	1,099
Consultants	70	40	40	45	195
Other Costs	540	469	456	459	1,924
Transport Levy	27,074	27,073	27,074	27,073	108,294
SLAs	403	411	419	427	1,660
Total Expenditure	**30,487**	**30,437**	**30,439**	**30,468**	**121,831**
Income					
Grant Income	(3,413)	(3,364)	(3,365)	(3,395)	(13,537)
Transport Levy	(27,074)	(27,073)	(27,074)	(27,073)	(108,294)
Total Income	**(30,487)**	**(30,437)**	**(30,439)**	**(30,468)**	**(121,831)**
Net Position (Inc)/Exp	**0**	**0**	**0**	**0**	**0**

In developing these budget proposals, the Mayor and Cabinet have been clear in their approach to ensuring the North of Tyne Authority is a lean organisation. The budget proposals include the anticipated capacity required to deliver the ambition of the authority and will be regularly reviewed as the delivery of key priorities and actions progress. The bulk of expenditure is funded through devolved funding secured through the devolution deal, and contributions from constituent authorities of £37,000 each.

The Mayor and Cabinet will continue to work with officers to maximise the opportunities of the three constituent authorities working together efficiently and effectively with the North of Tyne Combined Authority. Much of this is now in place through the development of the Service level Agreements for support services such as Human Resources, Legal Services, Treasury Management Support, Procurement Support, Internal Audit, Data Protection and ICT Capacity. New project and grant management systems are currently under consideration.

1.2 **Draft Investment Fund budget**

The Investment fund sets out costs associated with the development, management and delivery of projects to be funded through the Investment fund.

To date 25 projects have been agreed committing £15.6m of the Investment Fund with a further £67m identified projects in the pipeline identified through recent sector commissioning work. Agreed projects to date include:

- Inward Investment Fund (£3m)
- NU Futures (£2.6m)
- Inclusive Economy Co-financing Fund (£3m)
- North of Tyne Rural Business Growth Project (£1.2m)

The investment to date has secured over £59.6million of additional funding into the NTCA area through the provision of match funding, and the expectation that in the region of 1122 jobs will be created through the projects approved to date.

Based on the Mayor and Cabinet's plans to ensure delivery of the Vision of the authority the Draft Investment Fund budget is set out in Table 2 below.

Table 2 NTCA Draft Investment Fund Budget 2020-21 – 2023-24

	4-Yr Investment Fund Budget				
	2020-21	**2021-22**	**2022-23**	**2023-24**	**Total**
	£'000	£'000	£'000	£'000	£'000
Expenditure					
Business Case Development Fund	1,780	1,000	1,000	763	4,543
Investment Projects	12,000	20,000	25,000	28,000	85,000
Technical Support	250	250	250	250	1,000
Corporate Contribution	1,392	2,188	2,206	2,203	7,989
Total Expenditure	**15,422**	**23,438**	**28,456**	**31,216**	**98,532**
Income					
Funding Sources	(20,000)	(20,000)	(20,000)	(20,000)	(80,000)
Total Income	**(20,000)**	**(20,000)**	**(20,000)**	**(20,000)**	**(80,000)**

Net Position (Inc)/Exp	**(4,578)**	**3,438**	**8,456**	**11,216**	**18,532**
Brought forward funding	(35,669)	(40,247)	(36,809)	(28,353)	(35,669)
Cumulative Position	**(40,247)**	**(36,809)**	**(28,353)**	**(17,137)**	**(17,137)**

Included in the draft budget is provision for Technical Support, this is a requirement of the Assurance Framework that Investment Fund proposals are subject to external independent testing. Any unspent Investment Fund will be held and transferred to a specific reserve at the year end to support the delivery of the programme of work in future years.

1.3 Draft Adult Education budget (AEB)

As part of the devolution deal the Combined Authority is progressing the devolution of the Adult Education Draft budget. The devolution of AEB will give the authority significant new powers and responsibilities in delivering both their mayoral priorities and the national skills agenda and priorities. The statutory order to devolve the AEB to NTCA is currently going through the necessary parliamentary process and it is anticipated that the AEB will be transferred to NTCA for the academic year 2020-21 onwards.
AEB costs are collected within the Corporate Draft budget with a contribution of 3% of overall AEB income made towards Corporate support costs.
Table 3 below reflects a high-level balanced draft budget is then expected with all funding to be awarded to grant providers and other procured deliveries. The expected split between grant and procured service is also detailed, based on historic delivery.

Table 3 Draft AEB 2020-21 – 2023-24

	Draft 4-Yr Budget				
	2020-21	**2021-22**	**2022-23**	**2023-24**	**Total**
	£'000	**£'000**	**£'000**	**£'000**	**£'000**
Expenditure					
Grant Awards	15,369	15,369	15,369	15,369	61,476
Procured Services	6,659	6,659	6,659	6,659	26,636
Corporate Contribution	678	678	678	678	2,712
Total Expenditure	22,706	22,706	22,706	22,706	90,824
Income					
Funding Sources and Total Income	(22,706)	(22,706)	(22,706)	(22,706)	(90,824)
Net Position (Inc)/Exp	**0**	**0**	**0**	**0**	**0**

1.4 Mayoral Precept

No provisions have been included in the Financial Plan for a Mayoral precept

1.5 Treasury Management Strategy

The Authority is required to approve a Treasury Management Strategy each year and this is attached at Appendix A for approval. A Service Level Agreement is now in place with North Tyneside Council for support in this area. Additional work will progress during 2020-21 to identify potential synergies from alignment of the Treasury Management Strategy of this Authority with those of the constituent authorities, and the outcome of this work will be brought back to Cabinet for their consideration in due course.

1.6 Prudential Indicators and MRP Policy

The new arrangements set out in the NECA and NTCA Orders require decisions about the Transport Revenue Draft budget and Levies and the Transport Capital Programme to be determined by the new Joint Transport Committee (JTC). The transport functions and assets still rest with each Combined Authority but can only be exercised or deployed through the decisions of the Joint Transport Committee.

As previously outlined to Cabinet a proportion of the outstanding balance of the loans and investments (based on the share of Tyne and Wear population in each combined authority areas) will be shown in the balance sheets of the two Combined Authorities. It may be necessary for the individual loan agreements with lenders to be amended to reflect the new arrangement for the share of liabilities between the two Combined Authorities. The Mayor and Cabinet are required to be aware of the associated prudential indicators and MRP policy associated with the loans and Investments which are included in the draft budget report for the NECA as the relevant accountable body. There is no change to the details of these as in the report to Cabinet on 5 February. A summary of the Loans outstanding at the date of the change in governance is set out in Table 4 below.

Table 4: Transport (Tyne and Wear) Outstanding Debt, and Capital Financing Requirement at 2nd November 2018

	Principal	Interest Due	Total	NECA Share	NTCA Share
	£000	£000	£000	£000	£000
Capital Financing Requirement	193,665		193,665	107,883	85,782
Actual External Debt	167,333	2,274	169,607	94,482	75,125

The Prudential Indicators and MRP policy for the Transport Asset and liabilities and NECA Draft budget remain unchanged from the report to Cabinet on 5 February 2019.

At this early stage of the North of Tyne Combined Authority there is no borrowing requirement associated with the delivery of the Vision and priorities, therefore the Authority does not yet require its own Prudential Indicators or an MRP policy. These will be developed when necessary and brought back to Cabinet as part of the Draft budget and Financial Planning process in future years.

1.7 Transport Levy

Cabinet are aware that the North of Tyne and the North East Combined Authorities are required under the Transport Levying Bodies regulations to set the Revenue Draft budget and associated Transport Levies before 15 February 2020, in order to enable their constituent councils to take the levies and other contributions into account in setting their own draft budgets. It is anticipated that the Transport Levy for 2020-21 will be frozen at current year levels.

1.8 Reserves

As set out in the Draft budget report to Cabinet on the 4 December 2018, a Corporate reserve of £200k was created. The level of reserve will remain under review as the Authority develops and new information becomes available about the financial risks facing NTCA and the arrangements in place for managing those risks.

1.9 Pooling of Business Rates and 75% Business Rates Retention Pilot

In the Final Local Government Finance Settlement for 2019-20, it was confirmed that the North of the Tyne's expression of interest to become a 75% Business Rate Retention Pilot was successful for 2019-20. The three constituent authorities are currently part of a pooling arrangement for the North of the Tyne. A key feature of becoming a 75% business rates pilot is that Business Rate income above the current 49%/50% retention arrangements will be pooled across the pilot. The value of this additional income will be confirmed when the final NNDR3 return is completed for the pool during May 2020. At that time any additional growth secured will be available to the Combined Authority to further support the delivery of the Vision, working at a local level within the three constituent authorities.

The Spending Review announced in September 2019 determined that the 2019-20 75% Business Rates Retention pilots would not continue beyond 2019-20.

1.10 The LEP Accountable Body Arrangements

When the North of Tyne Combined Authority was established the 7 North East authorities agreed that the former NECA's accountable body responsibilities should be shared between the new NECA and NTCA. The intention is that the NTCA will take on the accountable body function for the North East LEP, while NECA will act as accountable body for the Joint Transport Committee. The budget will need to reflect decisions about the level of government grant available to support North East LEP costs as well as the guidance and resource requirements needed to meet grant conditions. A further report will be brought back to this Cabinet once the LEP have made their decision regarding the accountable body function.

2. **Potential Impact on Objectives**

The North of Tyne Combined Authority Vision document sets out the strategic objectives of the Authority, detailing the key priorities and the first steps in the journey around the six key pillars. The draft budget will enable the Authority to properly discharge its functions and assist in delivering the Authority's vision, policies and priorities.

3. **Key Risks**

There are no key risks identified at this time.

4. **Financial and Other Resources Implications**

The report sets out finance and other resource considerations in detail.

5. **Legal Implications**

The Authority is required to agree a balanced draft budget annually and to monitor that draft budget throughout the year. The Authority must also make provision for an adequate level of un-earmarked reserves. It is also required to ensure that good financial governance arrangements are in place.

6. **Consultation/Engagement**

The creation of the North of Tyne Combined Authority has been subject to significant regional and national engagement. The 2020-21 Draft budget is based on the devolution deal and the statutory order which created the Authority, and the Authority's Vision which has been agreed by Cabinet and is being shared with stakeholders in a range of events.

The Mayor and Cabinet will consider any recommendations from the Overview and Scrutiny Committee in January 2020 before finalising the budget in February 2020.

7. **Appendices**

Appendix A Treasury Management Strategy

8. **Background Papers**

8 November Cabinet Report: North Tyneside Combined Authority Vision and Emerging Priorities of Early Investment.
The Combined Authorities (Finance) Order 2017.
Statutory Instrument No 1133 (2018) The Newcastle Upon Tyne, North Tyneside and Northumberland Combined Authority (Establishment and Functions) Order 2018.
8 November Cabinet 2018/19 Draft budget Report
5 February Cabinet 2019/20 Draft budget Report
26 September Cabinet NTCA Financial Planning Draft Budget Process

9. **Contact Officers**

Janice Gillespie, Chief Finance Officer,
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10. Sign-off

Head of Paid Service: Yes
Monitoring Officer: Yes
Section 73 Officer: Yes

Appendix A

North of Tyne Combined Authority

Treasury Management Policy Statement & Strategy 2020-21

Background

The Authority is required to operate a balanced budget, which means that cash raised during the year will meet cash expenditure. A key part of the Authority's treasury management function is to ensure that cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in low risk counterparties or instruments commensurate with the Authority's low risk policy, providing adequate security and liquidity before considering investment return.
Another key element of the treasury management function is the management of the funding associated with the Authority's capital investment plans. These capital plans provide a guide to any borrowing needs of the Authority, essentially the longer-term cash flow planning to ensure that the Authority can meet its capital spending obligations. This management of longer-term cash may involve arranging long or short-term loans or using longer-term cash flow surpluses. Although the Authority has not identified any imminent borrowing plans other than in respect of the relevant share of the Joint Transport Committee liabilities, it is starting to engage in discussions with Government to obtain borrowing powers so that these are in place when borrowing is required.
The contribution the treasury management function makes to the Authority is critical, as the balance of debt and investment operations ensure liquidity or the ability to meet spending commitments as they fall due, either on day-to-day revenue or on larger capital projects. The treasury operations will see a balance of the interest costs of debt and the investment income arising from cash deposits affecting the available budget. Since cash balances generally result from reserves and balances, it is paramount to ensure adequate security and liquidity of the sums invested.

Statutory Requirements

The Authority has a legal obligation under the Local Government Act 2003 to have regard to the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice; the Chartered Institute of Public Finance and Accountancy's Prudential Code: Capital Finance in Local Authorities and the Ministry of Housing, Communities and Local Government (MHCLG) Statutory Guidance on Local Government Investments.
The CIPFA Treasury Management Code requires the Authority to approve a treasury management strategy before the start of each financial year.
In addition, the MHCLG guidance requires the Authority to approve an investment strategy before the start of each financial year.
The CIPFA Treasury Management Code and the Prudential Code are closely linked. The Authority is required to have regard to the Prudential Code when setting limits to the level of its affordable borrowing. The 2017 update to the Prudential Code drew together the reporting requirements of the Prudential Code and the Treasury Management Code resulting in the requirement for the Authority to produce a capital

strategy that includes specific requirements in respect of debt and borrowing and treasury management. An investment strategy will be produced when the Authority has determined potential borrowing limits through dialogue with the Treasury.

Effective Treasury Management

The Authority will create and maintain, as the cornerstones for effective treasury management:

- A treasury management policy statement, stating the policies, objectives and approach to risk management of treasury management activities
- Suitable Treasury Management Practices (TMPs), setting out the way the Authority will seek to achieve its policies and objectives and detail how it will manage and control treasury management activities.

Reporting

The following reports will be issued during the financial year for approval by Cabinet:

- An annual report on the Authority’s treasury management strategy and plan to be pursued in the coming year. This will include an investment strategy and will be considered by Cabinet as part of the budget approval process.
- A mid-year review report. This will update members on the progress of the capital position, show amended prudential indicators where required and performance against the strategy.
- An annual report, after year end closure on the performance of the treasury management function, on the effects of decisions taken and the transactions executed in the past year, and any circumstances of non-compliance with the treasury management strategy and TMPs.

Responsibilities

Cabinet has responsibility to ensure the implementation and regular monitoring of its treasury management policies delegates the responsibility for the execution and administration of treasury management decisions to the Chief Finance Officer, who will act in accordance with the organisation’s policy statement and TMPs.
Responsibility for ensuring effective scrutiny of the treasury management strategy and policies is delegated to Overview and Scrutiny Committee.
The Authority’s treasury management function is proposed to be managed under a service level agreement with North Tyneside Council.
The Treasury Management functions of the Joint Transport Committee are approved as part of the North East Combined Authority budget setting process in their role as Accountable Body. A review of the NECA Treasury Management Strategy has been undertaken and is in line with that of the Authority.

Training

The CIPFA Treasury Management Code requires the responsible officer to ensure those members with responsibility for treasury management receive adequate training in treasury management. This especially applies to members responsible for scrutiny.

Treasury Management Policy Statement 2020-21

The Authority defines its treasury management activities as:
"The management of Authority's investments and cash flows, its banking, money market and capital transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."

Risk Management

The Authority regards the successful identification, monitoring and control of risk to 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 risk implications for the organisation, and any financial instruments entered into to manage those risks.

Value for Money

The Authority 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 employing suitable comprehensive performance measurement techniques, within the context of effective risk management.

Borrowing Policy

At this current time the Authority does not have the powers to borrow other than for Transport responsibilities, the borrowing that will be reflected in this Authority's statement of accounts relates to historic Tyne and Wear Transport activities and the financing and borrowing costs are met by the Tyne and Wear Levy. Details of which are included the Treasury Management Strategy and Prudential Indicators of the North East Combined Authority as the appointed accountable body.

Investment policy

The Authority's primary objectives for the investment of its surplus funds are to protect the principal sums invested from loss, and to ensure adequate liquidity so that funds are available for expenditure when needed. The generation of investment income to support the provision of the Authority's services is an important, but secondary, objective.

The Authority will have regard to the MHCLG Guidance on Local Government Investments and will approve an investment strategy each year as part of the treasury management strategy. The strategy will set criteria to determine suitable organisations with which cash may be invested, limits on the maximum duration of such investments and limits on the amount of cash that may be invested with any one organisation.

Treasury Management Strategy for 2020-21

The proposed strategy for 2020-21 in respect of the following aspects of the treasury management function is based upon the treasury management officers' view on interest rates, supplemented with market forecasts provided by to North Tyneside Council's treasury advisor, Link Asset Services. This strategy covers:

- Treasury management consultants
- The current treasury portfolio position;
- Prospects for interest rates;
- The borrowing strategy;
- Sources of borrowing
- Policy on borrowing in advance of need;
- The investment strategy;
- Financial investments;
- Creditworthiness;
- Liquidity management;
- Non-financial investments; and
- Policy on the use of financial derivatives

Treasury Management Consultants

Through a service level agreement with North Tyneside Council, the Authority proposed to appoint its own external treasury management advisors.
Whilst the Authority has the intention to appoint external treasury management advisors it recognises that responsibility for treasury management decisions remains with the Authority at all times and will ensure that undue reliance is not placed upon the services of our external service providers. All decisions will be undertaken with regards to all available information, including, but not solely, that from any appointed treasury advisers.
It also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The Authority will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented and subjected to regular review.

Current Treasury Portfolio Position

The Authority's Investment position as at November 2019 is set out in Table 1 below:

Table 1: Current Treasury Portfolio as at 30 November 2019

Investments	Average level of Investment	Average Rate Interest earned
	£m	**%**
Investments DMO*	38	0.59
Total	**38**	

*Debt Management Office

The authority has now received £40m of the devolved funding to date in relation to the Investment Fund, £20m in relation to 2018/19 and then a further £20m in relation to 2019/20. There is currently £38m invested in the UK Central Government (Debt Management Office) this being considered a low risk counterparty/instrument commensurate with the Authority's low risk policy, providing adequate security and liquidity before considering investment return.

Prospects for Interest Rates

The Authority through its service level agreement with North Tyneside Council for treasury management services currently has access to Link Asset Services as its external treasury advisor and part of their service is to assist the Authority to formulate a view on interest rates. The table below sets out Link Asset Services professional view of interest rates.

Link Asset Services forecast interest rates – (October 2019)

	Bank Rate %	5 year PWLB %	10 year PWLB %	25 year PWLB %	50 year PWLB %
Sep-19	0.75	2.20	2.50	3.10	3.00
Dec-19	0.75	2.30	2.60	3.30	3.20
Mar-20	0.75	2.50	2.80	3.40	3.30
Jun-20	0.75	2.30	2.90	3.50	3.40
Sep-20	0.75	2.40	3.00	3.60	3.50
Dec-20	1.00	2.40	3.00	3.70	3.60
Mar-21	1.00	2.80	3.10	3.70	3.60
Jun-21	1.00	2.90	3.20	3.80	3.70
Sep-21	1.00	3.00	3.30	3.90	3.80
Dec-21	1.00	3.00	3.30	4.00	3.90
Mar-22	1.25	3.10	3.40	4.00	3.90

From time to time, gilt yields, and therefore PWLB rates, can be subject to exceptional levels of volatility due to geo-political, sovereign debt crisis, emerging market developments and sharp changes in investor sentiment. Such volatility could occur at any time during the forecast period.
Economic and interest rate forecasting remains difficult with so many external influences weighing on the UK. The above forecasts, and MPC decisions, will be liable to further amendment depending on how economic data and developments in financial markets transpire over the next year. Geographical developments, especially in the EU, could also have a major impact. Forecasts for average investment earnings beyond the three-year time horizon will be dependent on economic and political developments.

Investment and Borrowing Rates

Investment returns are likely to remain low during 2020-21 but to be on a gently rising trend over the next few years;

Borrowing interest rates have been volatile so far in 2019-20 and have increased modestly since the summer. This increase is expected to continue over the next few years (see table above).

Borrowing Strategy

At this current time the Authority does not have the powers to borrow other than for Transport responsibilities, the borrowing that will be reflected in this Authority's statement of accounts relates to historic Tyne and Wear Transport activities and the financing and borrowing costs are met by the Tyne and Wear Levy. Details of which are included the Treasury Management Strategy and Prudential Indicators of the North East Combined Authority as the appointed accountable body.

Annual Investment Strategy

Investment policy

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.
The Authority's investment strategy will give consideration to core balances and cash flow requirements and the outlook for short-term interest rates. Where cash flow identifies cash sums that could be invested for longer periods (potentially obtaining a greater return), the value to be obtained from longer term investments will be carefully assessed.
If it is thought that the Bank Rate is likely to rise significantly within the time horizon being considered, then consideration will be given to keeping most investments as being short term or variable. Conversely, if it is thought that Bank Rate is likely to fall within that time period, consideration will be given to locking in higher rates currently obtainable, for longer periods.
Both the CIPFA Treasury Management Code and MHCLG guidance require the Authority to invest any funds prudently and to have regard to the security and liquidity of its investments before seeking the highest rate of return or yield.
The above Code and guidance also emphasises the importance of the management of risk within treasury management functions. This Authority has adopted a prudent approach to managing risk and defines its risk appetite by the following means: -

- Minimum acceptable credit criteria are applied in order to generate a list of highly creditworthy counterparties. This also enables diversification and thus avoidance of concentration risk. The key ratings used to monitor counterparties are the short term and long-term ratings.

- Credit ratings will not be the sole determinant of the quality of an institution; it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. Any assessment will also take account of information that reflects the opinion of the markets. To achieve this consideration the Authority will engage with its advisors to maintain a monitor on market pricing such as credit default swaps and overlay that information on top of the credit ratings.

- Other information sources used will include the financial press, share prices and other such information pertaining to the banking sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.

- The Authority has defined a list of types of investment instruments that the treasury management function is authorised to use. There are two lists in under the categories of 'specified' and 'non-specified' investments.

Financial Investments

The CIPFA Treasury Management Code and the MHCLG guidance has now extended the meaning of 'financial investments' to include the following:
- Specified investments;
- Loans; and
- Non-specified investments.

Specified Investments

Specified investments are: denominated in sterling; repayable within 12 months (either because of an expiry date or through a non-conditional option); not defined as capital expenditure by legislation; and invested with a body or in an investment scheme described as high quality or invested with one of: the UK Government; a Local Authority; or a Parish Council or Community Council.

Loans

Loans could be to local enterprises, local charities, wholly owned companies and joint ventures as part of a wider strategy for local economic growth. In some cases, these loans may not be seen as prudent if adopting a narrow definition of prioritising security and liquidity. To allow such loans to be made whilst continuing to have regard to the MHCLG guidance Local Authorities must be able to demonstrate in their strategy that: -

- Total financial exposure to these types of loans is proportionate;
- That an allowed "expected credit loss" model for loans and receivables as set out in IFRS 9 Financial Instruments has been adopted to measure the credit risk of a portfolio;
- That appropriate credit control arrangements to recover overdue repayments is in place; and
- The Authority has formally agreed the total level of loans by type that it is willing to make, and their total loan book is within their self-assessed limit.

Non-specified Financial Investments

Non-specified investments are any investment not meeting the definition of a specified investment (less high credit quality, may be for periods in excess of 12 months, and are more complex instruments which require greater consideration by members and officers before being authorised for use).
The following table provides a list of specified investment instruments that are authorised to be used by the Authority, subject to cash limits and time limits indicated:

Table 2: Specified Investment Instruments

	Credit Criteria	**Maximum Deposit**	**Maximum Period**
Debt Management Agency Deposit Facility	UK Government backed	£50m	Unlimited
UK Local Authorities	N/A	£10m each	1 year
UK Government Treasury Bills	UK Sovereign Rating	£10m	1 year
Term deposits with banks and building societies	Blue /Orange Red Green No Colour	£5m each	12 months 6 months 100 days Not for use
Certificate of Deposits with banks and building societies	Blue /Orange Red Green No Colour	£5m each	12 months 6 months 100 days Not for use
Money Market Funds	AAA	£5m each	Liquid
Local Authority Controlled companies in the NTCA area		£5m	5 years

The following table provides a list of non-specified investment instruments that are authorised to be used by the Authority, subject to the cash limits and time limits indicated:

Table 3: Non-specified Investment Instruments

	Credit Criteria	Maximum Deposit	Maximum Period
UK Local Authorities	N/A	£5m each	3 years

The Authority has determined that it will limit the maximum total exposure to non-specified investments as being 25%
Investments will only be placed with counterparties from countries with a specified minimum sovereign rating.
All investments will be denominated in sterling.
The Authority will pursue value for money in treasury management and will monitor the yield from investment income against appropriate benchmarks for investment performance. Regular monitoring of investment performance will be carried out during the year.

Creditworthiness Policy

The minimum credit ratings criteria the Authority use will be a Short-Term rating (Fitch or equivalents) of F1 and a Long-Term rating of A-. There may be occasions when the counterparty ratings from one rating agency are marginally lower than these ratings, but they may still be used. In these instances, consideration will be given to the whole range of ratings available or other market information, to support their use.
The Authority also applies the creditworthiness service provided by Link Asset Services. This service employs a sophisticated modelling approach utilising credit ratings from the three main credit rating agencies; Fitch, Moody's and Standard & Poor's. Link Asset Services supplement the credit ratings of counterparties with the following overlays: -

- Credit watches and credit outlooks from credit rating agencies;
- Credit Default Swap (CDS) spreads to provide early warning of likely changes in credit ratings
- Sovereign ratings to select counterparties from only the most creditworthy countries

This modelling approach combines credit ratings, credit watches and credit outlooks in a weighted scoring system which is then combined with an overlay of CDS spreads for which the end product is a series of colour coded bands which indicate the relative creditworthiness of counterparties and are used by the Authority to determine the suggested duration of investments.
This service uses a wider array of information other than just primary ratings and by using a risk weighted scoring system it does not give undue preponderance to one agency's ratings.
The Authority is alerted to changes to ratings of all three agencies through its use of the Link Asset Services creditworthiness service.
If a downgrade results in the counterparty no longer meeting the Authority's minimum criteria, its further use as a new investment will be withdrawn immediately.
In addition to the use of credit ratings the Authority will be advised of information in movements in credit default swap spreads against the iTraxx benchmark and other market data on a daily basis via its Passport website. Extreme market movements

may result in downgrade of an institution or removal from the Authority's lending list. Sole reliance will not be placed on the use of this external service. In addition, this Authority will also use market data and market information on any external support for banks to help support its decision-making process.
As a result, in the change in accounting standards for 2018/19 under IFRS 9, the Authority will consider the implications of investment instruments which could result in an adverse movement in the value of the amount invested and resultant charges at the end of the year.

Liquidity Management

Officers providing treasury management services to the Authority use purpose-built cash flow forecasting software to determine the maximum period for which funds may prudently be committed. The forecast is compiled on a prudent basis to minimise the risk to the authority of being forced to borrow on unfavourable terms to meet its financial commitments.

UK Banks – Ring Fencing

The largest UK banks are required, by UK law, to separate core retail banking services from their investment and international banking activities by 1st January 2019. This is known as ring-fencing. Whilst smaller banks with less than £25bn in deposits are exempt, they can choose to opt up. Several banks are very close to the threshold already and so may come into scope in the future regardless.
Ring-fencing is a regulatory initiative created in response to the global financial crisis. It mandates the separation of retail and small and medium-sized enterprise (SME) deposits from investment banking, in order to improve the resilience and resolvability of banks by changing their structure. In general, simpler, activities offered from within a ring-fenced bank, (RFB), will be focused on lower risk, day to day core transactions, whilst more complex and riskier activities are required to be housed in a separate entity, a non-ring-fenced bank, (NRFB). This is intended to ensure than an entity's core activities are not adversely affected by the acts or omissions of other members of its group.
While the structure of the banks included within this process may have changed, the fundamentals of credit assessment have not. The Authority will continue to assess the new formed entities in the same way that it does others and those with sufficiently high ratings, will be considered for investment purposes.

Non-Financial Investments

The MHCLG guidance defines an investment as all of the financial assets of a Local Authority as well as other non-financial assets that the organisation holds primarily or partially to generate a profit; for example, investment property portfolios. This may therefore include investments that are not managed as part of normal treasury management processes or under treasury management delegations. The definition of an investment also covers loans made by a local authority to one of its wholly-owned companies or associates, to a joint venture, or to a third party.
The Authority recognises that investment in other financial assets and property primarily for financial return, taken for non-treasury management purposes, requires careful investment management. Such activity includes loans supporting service outcomes, investments in subsidiaries, and investment property portfolios.

The Authority will ensure that all the organisation's investments are covered in the investment strategy and will set out, where relevant, the organisation's risk appetite and specific policies and arrangements for non-treasury investments. It will be recognised that the risk appetite for these activities may differ from that for treasury management.
The Authority will maintain a schedule setting out a summary of existing material investments, subsidiaries, joint ventures and liabilities including financial guarantees and the organisation's risk exposure.

Policy on the use of Financial Derivatives
Local Authorities generally have made use of financial derivatives embedded into loans and investments both to reduce interest rate risk and to reduce costs or increase income at the expense of greater risk. The general power of competence in Section 1 of the Localism Act 2011 removes much of the uncertainty over Local Authorities powers to use standalone financial derivatives such as swaps, forwards, futures and options. However, the Authority's policy is not to currently use these instruments.

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