APPENDIX 2

SOUTH YORKSHIRE MAYORAL COMBINED AUTHORITY

ANNUAL TREASURY MANAGEMENT STRATEGY 2022/23

Introduction

The annual treasury management strategy is forward looking and seeks to ensure that:

- The MCA's overarching Borrowing strategy is appropriate in the context of the current economic climate
- The MCA Group's capital plans are affordable, prudent and sustainable (as measured via a series of prudential indicators);
- Prudent charges are made to revenue for the repayment of debt by adopting a minimum Revenue provision (MRP) policy that is compliant with statutory MRP guidance
- investments and borrowings are organised in accordance with the MCA's risk appetite (as measured via a series of treasury indicators); and
- The MCA Group's investment strategy pays due regard to security (the management of risk and the protection of the principal sums invested) and liquidity (availability of cash to meet liabilities as they fall due) as first priorities and then what level of return (yield) can be obtained based on risk appetite and the contribution each investment activity makes.

The annual treasury management strategy is set in the wider context of the MCA's medium and longer term capital investment plans. At this stage, whilst business investment, capital infrastructure and transport programmes beyond 2021/22 are still being developed, the financial planning horizon has been limited to the three-year minimum specified by the Code based on existing commitments.

In addition, the annual treasury management strategy sets out the MCA Group's position on:

- borrowing in advance of need;
- debt rescheduling; and
- use of external service providers.

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

Proposed changes to CIPFA's Prudential Code and Treasury Management Code are currently out to consultation with the focus on ensuring that:

- risks associated with commercial property investment are properly addressed;
- treasury management staff and members receive adequate training to ensure that they have the necessary expertise, knowledge and skills to perform their duties; and
- treasury activities pay due regard to Environmental, Social and Governance risks over the sums invested.

The impact of these changes will be reported back in the mid-year report on treasury management.

Treasury management reporting

The annual treasury management strategy is the first of a minimum of three reports that will be reported in respect of 2022/23 treasury activity. As a minimum the two other reports will comprise:

- a mid year report which will provide an update on treasury activity for the first 6 months of the 2022/23 financial year; and

- an annual report which will report actual performance against the treasury management strategy after the end of the 2022/23 financial year.

In addition, should there be any material changes to the strategy or associated indicators these will be brought back for approval before being implemented.

The draft 2022/23 treasury management strategy was presented to the Audit Standards & Risk Committee in January 2022. The Committee endorsed the strategy for onward approval by the MCA Board.

Recommendations for the MCA Board on 21 March 2022

Members are asked to:

- Approve the annual treasury management strategy;
- Approve the borrowing strategy set out in Section A of the annual treasury management strategy;
- Approve the capital expenditure estimates and associated prudential indicators set out in Section B of the annual treasury management strategy;
- Approve the minimum revenue provision policy set out in Section C of the annual treasury management strategy;
- Approve the annual investment strategy set out in Section D of the annual treasury management strategy;
- Grant delegated authority to the Group Finance Director in consultation with the Chief Executive to provide a financial guarantee in favour of the SCR Financial Interventions Holding company; and
- Grant delegated authority to the Group Finance Director to negotiate with HM Treasury and DLUHC to agree a borrowing cap for allMCA functions (transport & non-transport) for 2022/23.

Borrowing Strategy

Previously, the borrowing strategy related solely to the transport functions of the MCA as, at the time of writing the 2021/22 TMS, the MCA had no borrowing powers in relation to its LEP functions.

However, this position is about to change in Q4 2021/22, to enable the MCA to borrow money for non-transport purposes, up to a Government agreed cap of £170.77m. These powers will be conferred by separate legislation: The Combined Authorities (Borrowing) Regulations 2022. A draft of this statutory instrument has been laid in Parliament and going through the various stages of approval. The Group Finance Director successfully negotiated with HM Treasury and DLUHC on the appropriate level of cap needed to meet the MCA's strategic plans - having regard to affordability, prudence and sustainability.

The proposed borrowing strategy for 2022/23 is to maintain the status quo, in other words: where possible to meet any borrowing need for the year internally from treasury investments rather than taking out external borrowing. This is in the expectation that the cost of new borrowing will continue to exceed likely investment returns. This plan will remain subject to the ongoing development of the investment strategy.

In addition, the proposed strategy is to repay debt as it falls due rather than to refinance debt. This assumption has been built into the financial plans resulting in a projected fall in debt servicing costs as debt is repaid.

The strategy also seeks to take the opportunity to reschedule existing debt where this will lead to an overall saving. However, for the reasons described further on in this report it is considered unlikely that any such opportunities will arise in the short to medium term.

Lending arrangements introduced by government in November 2020 tightened the rules governing local authorities, including MCAs, access to PWLB borrowing. The new rules do not allow access to PWLB where a local authority intends to buy commercial investment assets held primarily or partially to generate a profit for yield within its capital plans at any point in the next three years regardless of whether the transaction would notionally be financed from a source other than PWLB. The definition of commercial investment assets in this case is that contained within DLUHC Statutory Guidance on Local Government investments and includes, for example, investment property portfolios whose main purpose is to generate a profit.

The MCA Group's investment property portfolio is a legacy of bus deregulation and comprises former transport assets which are not being actively managed to achieve commercial returns. Accordingly, they are not considered to fall within the definition of commercial investment assets under the Statutory Guidance. This will however be kept under review should there be any plans to expand or diversify the portfolio.

Members are asked to note that £1m of gainshare revenue is reserved in the proposed 2022/23 revenue budget to support borrowing, should additional investment headroom be required. The £1m of gainshare set aside would support c. £40m of borrowing headroom.

Capital Expenditure Plans and Prudential Indicators: 2021/22 to 2024/25

Indicator 1 - Group Capital Expenditure estimates

The table below summarises the MCA Group's capital investment plans for the forthcoming year and indicative estimates for the following two years.

The estimates are based on known commitments at this point in time. It is highly likely that these commitments will change as new Government funding streams announced in the Spending Review come on-line, and the MCA begins to shape its own gainshare funded investment strategy. The estimates may also materially change should the MCA be successful in its bid into Government for additional transport capital funding in the new year, such as Levelling Up Fund. The estimates below reflect known commitments:

1. Group Capital Expenditure Estimates	2021/22	2022/23	2023/24	2024/25
	Forecast	Estimate	Estimate	Estimate
	£m	£m	£m	£m
City Region Sustainable Transport Settlement (CRSTS)	£0	£33	£72	£117
Transforming Cities Fund (TCF)	£12	£138	£12	£0
Parkway Widening	£8	£20	£0	£0
Active Travel	£1	£3	£0	£0
Growth Deal (Transport)	£0	£11	£2	£0
Business Investment (LGF)	£14	£10	£4	£2
Brownfield Fund	£2	£24	£13	£14
Getting Building Fund	£23	£4	£0	£0
Gainshare Capital - Place Investment	£8	£43	£18	£18
Miscellaneous minor schemes	£0	£5	£0	£0
Total Capital Investment	**£69**	**£289**	**£121**	**£150**

Indicator 2 – Capital Financing Requirement (CFR) estimates

The table below shows how the planned capital expenditure is expected to be financed. Any capital expenditure not funded by capital grants, capital receipts, or revenue contributions, results in a need for borrowing.

2. Group Capital Financing Estimates	2021/22	2022/23	2023/24	2024/25
	Forecast	Estimate	Estimate	Estimate
	£m	£m	£m	£m
Total capital investment	£69	£289	£121	£150
Government Grant - CRSTS	£0	£33	£72	£117
Government Grant - TCF	£12	£138	£12	£0
Government Grants - other transport	£9	£34	£2	£0
Government Grants - BrownField Fund	£2	£24	£13	£14
Government Grants - Getting Building Fund	£23	£4	£0	£0
Gainshare - capital	£8	£43	£18	£18
Capital Receipts - LGF	£14	£10	£4	£2

Capital Receipts - other	£0	£5	£0	£0
Total capital funding	**£69**	**£289**	**£121**	**£150**
Net borrowing needed for the year	**£0**	**£0**	**£0**	**£0**

The borrowing need stems from the decision taken in 2018/19 to borrow up to £23.3m over the 3-year period 2018/19 to 2020/21 to support capital investment in South Yorkshire transport schemes (Rotherham Interchange, re-railing and the transport capital pot).

The actual cumulative borrowing need over the period from 2018/19 to 2020/21 was £23.1m and therefore within the overall amount approved. The revenue implications of this borrowing have been factored intothe 2022/23 South Yorkshire transport revenue budget approved by the MCA at its meeting on 24 January 2022.

As noted above under the section on Borrowing Strategy, the MCA will be negotiating with HM Treasury and MHCLG on a borrowing cap for non transport purposes. This has been factored into the table above on the assumption that the necessary legislation will be passed.

Based on the above capital investment plans and capital financing proposals, the Group's overall forecast underlying need to borrow or Capital Financing Requirement (CFR) is forecast to change as follows:

Group Capital Financing Requirement	**2021/22**	**2022/23**	**2023/24**	**2024/25**
	Forecast	**Estimate**	**Estimate**	**Estimate**
	£m	**£m**	**£m**	**£m**
Opening CFR	**£109**	**£109**	**£106**	**£103**
movement in CFR				
Additional borrowing requirement	£3	£0	£0	£0
(deferred due to use of GBF in 2020/21)				
MRP	-£3	-£3	-£3	-£4
Capital receipts set aside for the repayment of Debt	£0	£0	£0	£0
Other adjustments	£0	£0	£0	£0
Closing CFR	**£109**	**£106**	**£103**	**£99**

Indicator 3 - Amount of external debt against the Capital Financing Requirement (CFR)

The purpose of this indicator is to assess the extent to which borrowing is only being used in the medium to longer term to finance capital expenditure. The benchmark recommended by CIPFA is that the estimated amount of gross debt should not exceed the estimated CFR for the current and following two years.

Group external borrowing	2021/22	2022/23	2023/24	2024/25
	Forecast	Estimate	Estimate	Estimate
	£m	£m	£m	£m
MCA Loans	£25	£25	£25	£21
Expected change in MCA Loans	£0	£0	-£4	-£4
SYPTE Debt	£108	£100	£92	£46
Expected change in SYPTE Debt	-£8	-£8	-£46	£0
Gross Debt	**£125**	**£117**	**£67**	**£63**
Capital Financing Requirement	£109	£106	£103	£99
Debt in excess of CFR	**£16**	**£11**	**-£36**	**-£36**

Historically, gross debt has exceeded CFR because MRP has been charged annually to the transport levy to write down the CFR but no loan repayments had taken place. As illustrated in the table above, this situation is now rebalancing as debt matures and significant loan repayments are being made. The turning point is in 2023/24 when £50m of debt will be repaid.

The repayment of borrowing is also drawing down on the cash investments built up in previous years for the repayment of debt with the consequence that the level of investments is also forecast to fall - see Investment Strategy - Table 2.

Indicator 4 - Ratio of Financing Costs to Net Revenue Stream

This indicator is a measure of the affordability of decisions taken to finance capital investment borrowing in the context of the Group's overall financial sustainability.

Ratio of financing costs to net revenue streams	2021/22	2022/23	2023/24	2024/25
	Forecast	Estimate	Estimate	Estimate
	£m	£m	£m	£m
Interest	£9	£9	£7	£4
MRP	£3	£3	£3	£4
Less Investment Income	-£1	-£1	-£1	-£1
Net Financing Costs	**£11**	**£11**	**£9**	**£7**
Income - transport levy	£54	£54	£54	£54
Finance Costs/Unrestricted Revenue Income %	20%	20%	16%	13%

Interest payable is principally fixed rate PWLB borrowing. The reduction in the amount of interest payable is therefore a function of PWLB debt being repaid as it matures. A significant amount of PWLB debt is scheduled to be repaid over the period to 2024/25 as illustrated in Indicator 3, hence, the downward trend.

The return on investments is a function of the average level of treasury investments and target returns which are expected to be achieved. The reduction in investment income reflects the fact that investments are being used to settle loan repayments as they fall due in accordance with the borrowing strategy thereby reducing the level of core funds. The expected returns on investments are also expected to decline as long term investments on which decent returns are currently being earned unwind - see Investment Strategy Table 2.

External Debt – borrowing limits – Indicators 5 and 6

There are two indicators on borrowing limits: the authorised limit and operational boundary.

The **authorised limit** represents a control on the maximum amount of debt the Group can borrow for capital investment and temporary cash flow purposes. Under Section 3 of the Local Government Act 2003 this limit is agreed by the MCA and cannot be revised without that body's agreement.

The authorised limit reflects the level of external debt which, while not desired, could be afforded in the short term, but is not sustainable in the long term.

The **operational boundary** is the maximum amount of money the Group expects to borrow during the financial year. It acts as a useful warning if breached during the year that underlying spend may be higher than expected or income lower than budgeted.

Authorised Limit	2021/22 Forecast £m	2022/23 Estimate £m	2023/24 Estimate £m	2024/25 Estimate £m
Loans	£673	£665	£658	£607
Other Long Term Liabilities	£11	£11	£10	£10
Total	**£684**	**£676**	**£668**	**£617**

Operational Boundary	2021/22 Forecast £m	2022/23 Estimate £m	2023/24 Estimate £m	2024/25 Estimate £m
Loans	£658	£650	£643	£592
Other Long Term Liabilities	£11	£11	£10	£10
Total	**£669**	**£661**	**£653**	**£602**

Both the Authorised Limit and Operational Boundary allow for up to a £500m increase in borrowing capacity to accelerate delivery of the Gainshare funded Investment Programme by bringing forward all uncommitted Gainshare capital that the MCA is due to receive in years 3 to 30 so that it can be invested upfront in the near term. The figure of £500m represents the upper limit of what is potentially affordable to enable the associated debt financing costs to be contained within the overall 30 year Gainshare allocation. It will also be subject to the borrowing cap that the MCA agrees on an annual basis with HM Treasury and DLUHC for non-transport purposes.

In addition, the authorised limit allows for an additional £40m headroom over the maximum expected amount of gross debt in 2022/23 (excluding the £500m referred to above) - the operational boundary allows for an additional £25m headroom. The headroom provides capacity for short term temporary borrowing to manage the MCA's cash position rather than having to realise higher yield longer term investments early before they are due to mature.

The MCA has ready access to temporary borrowing should the need arise through local authority to local authority lending. Currently, borrowing rates in the local authority to local authority market are around 0.25% to 0.5% for one to two year borrowing. In this context, having headroom of up to £40m is considered affordable in the short term.

The Other Long-Term Liabilities set out in the table above represents the PFI liability in respect ofDoncaster Interchange.

For some combined authorities, major changes to local authority accounting rules under IFRS 16 in respect of accounting for leasing may lead to "right of use" leased assets being brought on balance sheet which would increase the value of Other Long-Term Liabilities. The new accounting rules were due to come into effect in 2020/21 but implementation has now been deferred until the start of 2022/23.

Finance officers in the MCA and SYPTE have assessed the impact of IFRS16, and it is not expected that any other long term liabilities will need to be brought on balance sheet on 1 April 2022.

Indicator 7 – Maturity structure of borrowing

The maturity profile is important in ensuring there is sufficient liquidity to meet loan repayments as they fall due.

Maturity of Group borrowing:	Amount	
	£m	%
2021/22	8	6%
2022/23	8	6%
2023/24	50	38%
2024/25	4	3%
2025/26	4	3%
2026/27	4	3%
2027/28	22	16%
2028/29	0	0%
2029/30	4	3%
2030/31	4	3%
2043 to 2056	25	19%
Total	**£133**	**100%**

The level of core funds available up to and including 2023/24 (see Investment Strategy - Table 2) indicates that there are sufficient internal funds to meet loan repayments in the medium term without the need for external borrowing.

In the period 2024/25 to 2026/27 the amount raised as MRP through the levy will more or less match the loan repayments of £4m p.a. in each of these years. Hence, it is not until 2027/28 that there is a potential need for external borrowing. This is on the assumption that:

- Borrowing requirement - the net borrowing need is as set out in Indicator 2
- Market loans - there is no early repayment of market loans (considered very unlikely in the prevailing low interest rate environment - see Debt Rescheduling below)

Debt Rescheduling

Opportunities for debt rescheduling depend on the difference between the repayment rates on early redemption and the interest rates on existing debt.

Where repayment rates on early redemption are lower, a premium (cost) is payable. Where repayment rates are higher, a discount (saving) can be obtained.

In the present low interest rate environment, PWLB rates for early repayment are currently in the range of 0.5% to 1.25%. This is significantly lower than rates on the Group's existing PWLB debt portfolio which range from 4.25% to 8.50%. Early repayment would therefore incur a very substantial premium.

The interest rates on the Group's market loans range from 4.50% to 4.95%. As these are considerably higher than the prevailing rates it is considered unlikely that the lender would exercise their call option which would trigger an opportunity to repay the debt early and refinance it by cheaper PWLB debt.

The prospect of refinancing or paying off early some of the underlying PFI debt relating to Doncaster Interchange in order to reduce future unitary payments over the remainder of the PFI term is discussed at the regular review meetings with the PFI Operator. No such opportunities have presented themselves to date.

Borrowing in advance of need

The MCA 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 forward approved Capital Financing Requirement estimates and will be considered carefully to ensure that value for money can be demonstrated and that the MCA can ensure the security of such funds.

Risks associated with any borrowing in advance will be subject to prior appraisal and reporting through the mid-year treasury report or annual report on treasury management.

Financial guarantee

The MCA has a wholly owned subsidiary, the SCR Financial Interventions Holding Company, whose sole purpose is to hold finance to support the delivery of the LGF programme. The company does not trade, is controlled by the MCA Executive and only has intercompany transactions with the MCA.

Under Companies Act legislation, the company can be made exempt from the requirement for audit, and therefore saves the public purse, if the MCA as parent provides a financial guarantee in the required format stating the financial year to which it relates.

The effect of the guarantee is that the MCA guarantees all outstanding liabilities to which the company is subject at the end of the financial year to which the guarantee relates until they are satisfied in full; and, the guarantee is enforceable against the MCA by any person to whom the company is liable in respect of those liabilities. However, as the company's only liability is to the MCA, there is no risk to the MCA group.

It is therefore proposed that the MCA provides a financial guarantee in respect of the 2021/22 financial year and that this remains in force if and until such time that the company transacts with parties other than the MCA. As the MCA's Financial Regulations allow the Group Finance Director to enter into any borrowing, investment and financing arrangements on behalf of the Authority compliant with the Treasury Management Policy, it is recommended that delegated authority be given to the Group Finance Director to provide the financial guarantee on the MCA's behalf for filing with Companies House.

Use of external advisors

Link Asset services have been appointed as treasury advisors to the MCA to provide technical guidance and support on treasury matters, including providing a creditworthiness service on financial institutions and other potential counterparties.

The MCA also has a service level agreement with Sheffield City Council to provide day to day banking and treasury services including managing the MCA's investment portfolio on its behalf.

Where external advisors are appointed to provide specialist skills and resources, officers will ensure that the terms of their appointment and methods by which their value will be assessed are properly agreed and documented.

Minimum revenue provision (MRP) policy statement

This policy statement has been prepared having regard to the Revised Statutory MRP Guidance issued in 2018. This limited the maximum number of years over which MRP can be charged to 50 years unless a suitably qualified professional advisor advises that the related asset will deliver service functionality for more than 50 years.

In practice, this change will have little or no practical effect on the existing profile of MRP charges.

The broad aim of MRP is for an authority to make a prudent provision by charging revenue over time to reduce its Capital Financing Requirement. In doing so, an authority should align the period over which they charge MRP to one that is commensurate with the period over which its capital assets / expenditure provides benefits either in terms of service potential or economic return.

Regulation 28 of the *Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 [as amended]* gives local authorities flexibility in how they calculate MRP, providing the calculation is 'prudent'. In calculating a prudent provision, local authorities are required to have regard to statutory guidance on determining MRP which offers a number of options for meeting this requirement.

In addition, an authority may charge an amount greater than the statutory minimum should it wish to do so. The MCA has not elected to charge in excess of the minimum statutory amount to date and has no plans to do so in 2022/23.

The MCA is recommended to approve the following MRP statement for financial year 2022/23:
MRP on the residual Capital Financing Requirement at the end of 2015/16 relating to capital expenditure incurred before 1st April 2008, is being charged on a flat line basis over fifty years. This is considered a more prudent approach to the "regulatory method" adopted up to and including 2015/16, as it better aligns the charges to revenue to the benefits the related assets deliver.

MRP on capital expenditure incurred since 1st April 2008, financed by unsupported borrowing will be based on the 'asset life method'. This means that MRP will be based on the estimated useful life of the assets created. The MCA will apply a maximum life of 50 years to new assets unless a suitably qualified professional advisor advises that an asset will deliver service functionality for more than 50 years or where an asset is a lease or PFI asset, and the length of the lease/PFI contract exceeds 50 years. MRP will commence in the year after an asset becomes operational to align charges to revenue to the economic benefits generated from those assets.

MRP on capital loans and capital grants awarded to partners and third parties financed by borrowing will be charged over the useful life of the assets concerned.

MRP on capital expenditure on assets not owned by the MCA or on assets for use by others will similarly be charged over the useful life of the assets concerned. MRP on expenditure capitalised by virtue of a statutory direction, repayment of capital grants or loans received, or acquisition of share capital, will be charged over a period not exceeding the maximum period specified by regulation.

If, as noted in the section concerning the Authorised Limit and Operational Boundary, the MCA agrees to maintain its borrowing capacity at £500m to accelerate delivery of the South Yorkshire Renewal Plan, Gainshare capital will be applied in the first instance to meet the requirement to set aside an amount torepay debt in lieu of charging revenue.

Members are asked to note the consultation on MRP changes currently underway. The draft proposals on this consultation may preclude the use of capital grant in-lieu of charging revenue. The MCA is engaging DLUHC on this issue and believes it has a strong basis to challenge the proposals.

Investment strategy

The MCA's investment policy has regard to the following:

- MHCLG's Guidance on Local Government Investments;
- CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes 2017; and
- CIPFA Treasury Management Guidance Notes 2018.

The MCA's investment priorities will be security first, portfolio liquidity second and then yield (return). The MCA will aim to achieve the optimum return (yield) on its investments commensurate with proper levels of security and liquidity and with the MCA's risk appetite.

MHCLG and CIPFA place a high priority on the management of risk. Accordingly, the MCA 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.

- A defined list of **types of investment instruments** that the treasury management team are authorised to use. These fall into two categories - 'specified' and 'non-specified' investments.

    - **Specified investments** are those with a high level of credit quality and subject to a maturity limit of one year or have less than a year left to run to maturity if they were originally classified as being non-specified investments solely due to the maturity period exceeding one year.
    - **Non-specified investments** are those with less high credit quality, may be for periods in excess of one year, and/or are more complex instruments which require greater consideration by members and officers before being authorised for use.

- **Lending limits** (amounts and maturity) for each counterparty will be set through applying the matrix in Table 4

- A limit on investments which are invested for **longer than 365 days** - see Table 2

At the advent of the Covid 19 pandemic the Bank of England took emergency action in March 2020 to reduce the base rate to first 0.25% and then to a historic low of 0.10%. The base rate remained at this level until 16 December 2021 when it was raised to 0.25% and raised again to 0.50% on the 3 February. This, together with the Government's fiscal stimulus package, has resulted in returns on traditional types of investment being suppressed. This is likely to remain the case in the medium term as illustrated in the table in the section below on Prospectsfor Interest Rates.

In view of this and in accordance with the 2020/21 annual treasury management strategy, preliminary discussions took place last year with the Group's treasury advisors and bankers on options to diversify into other types of pooled investment funds including, for example:

- Short dated bond funds (suitable for investors with a minimum time horizon of 2 to 3 years);
- Property Funds (suitable for investors with a minimum time horizon of at least 5 years); and
- Multi-asset income funds (suitable for investors with a minimum time horizon of at least 5 years).

These types of investment can generate a higher rate of return but inevitably at a greater risk than traditional types of investment. A comprehensive understanding of the varying degrees of risks associated with these types of investment is therefore required to assess against the potential rewards having regard to appropriate professional advice from external advisors.

Given the risks and uncertainties in the current economic climate, the focus for the time being at least, has been and will continue to be on maximising returns from traditional types of investment rather than on diversification.

Investment Performance

Over the course of 2021/22 in the 9 months to December 2021, the average size of the investment portfolio was £418m with the weighted average return on investments falling from 0.55% in April 2021 to 0.31% in December 2021 and averaging 0.37% for the 9 months to date.

The types of investment included within the investment portfolio are the more traditional ones held by local authorities, namely:

- Deposits with local authorities through the local authority to local authority market;
- Call accounts with reputable banks with a high credit rating; and
- Low volatility low risk highly liquid Money Market Funds which provide for instant access.

The returns on all of these types of investment have declined over the year with the average return now being 0.79% on local authority deposits (including longer term investments), 0.35% on call accounts and 0.06% on Money Market Funds.

The reason for the weighted average return for the 9 months to date of 0.37% being higher than the returns on traditional investments is due to the higher returns being earned on longer term fixed interest local authority deposits of more than 365 days duration. As at January 2022 there were £40m of such longer investments on which the average return was 1.20%.

Table 1 - Prospects for interest rates

Link Group Interest Rate View	7.2.22												
	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	0.75	1.00	1.00	1.25	1.25	1.25	1.25	1.25	1.25	1.25	1.25	1.25	1.25
3 month av. earnings	0.80	1.00	1.00	1.20	1.20	1.20	1.20	1.20	1.20	1.20	1.20	1.20	1.20
6 month av. earnings	1.00	1.10	1.20	1.30	1.30	1.30	1.30	1.30	1.30	1.30	1.30	1.30	1.30
12 month av. earnings	1.40	1.50	1.60	1.70	1.70	1.60	1.60	1.50	1.40	1.40	1.40	1.40	1.40
5 yr PWLB	2.20	2.30	2.30	2.30	2.30	2.30	2.30	2.30	2.30	2.30	2.30	2.30	2.30
10 yr PWLB	2.30	2.40	2.40	2.40	2.40	2.40	2.40	2.40	2.40	2.40	2.40	2.40	2.40
25 yr PWLB	2.40	2.50	2.50	2.60	2.60	2.60	2.60	2.60	2.60	2.60	2.60	2.60	2.60
50 yr PWLB	2.20	2.30	2.30	2.40	2.40	2.40	2.40	2.40	2.40	2.40	2.40	2.40	2.40
Bank Rate													
Link	0.75	1.00	1.00	1.25	1.25	1.25	1.25	1.25	1.25	1.25	1.25	1.25	1.25
Capital Economics	0.75	1.00	1.25	1.25	1.50	1.75	2.00	2.00	-	-	-	-	-
5yr PWLB Rate													
Link	2.20	2.30	2.30	2.30	2.30	2.30	2.30	2.30	2.30	2.30	2.30	2.30	2.30
Capital Economics	2.10	2.20	2.30	2.40	2.60	2.70	2.80	3.00	-	-	-	-	-
10yr PWLB Rate													
Link	2.30	2.40	2.40	2.40	2.40	2.40	2.40	2.40	2.40	2.40	2.40	2.40	2.40
Capital Economics	2.20	2.30	2.40	2.50	2.70	2.80	2.90	3.00	-	-	-	-	-
25yr PWLB Rate													
Link	2.40	2.50	2.50	2.60	2.60	2.60	2.60	2.60	2.60	2.60	2.60	2.60	2.60
Capital Economics	2.40	2.50	2.60	2.70	2.80	3.00	3.10	3.20	-	-	-	-	-
50yr PWLB Rate													
Link	2.20	2.30	2.30	2.40	2.40	2.40	2.40	2.40	2.40	2.40	2.40	2.40	2.40
Capital Economics	2.10	2.30	2.40	2.60	2.70	2.90	3.00	3.20	-	-	-	-	-
Capital Economics forecast for Bank of England QE stock													
£bn	895	870	845	805	770	740	705	635	585	-	-	-	-

As shown in the forecast table above, the Bank Rate is expected to increase to 1.25% over the next three years as the Bank of England takes action to counter the threat of inflation. During this period, economic recovery is expected to be only gradual and, therefore, prolonged.

Returns on investments are expected to remain suppressed at or below 1.0% on investments of shorter duration and at or below 1.20% on investments of 12 months**.**

PWLB interest rates on borrowing are expected to rise to around 2.0% to 2.6%, depending on the term of the loan, over the next three years.

Table 2 - Core funds and balances and longer term investments of more than 365 days

Core Funds	2021/22 Forecast £m	2022/23 Estimate £m	2023/24 Estimate £m	2024/25 Estimate £m
Reserves and balances - revenue and capital	£89	£80	£76	£86
Cash set aside to repay debt	£16	£11	-£36	-£36
Capital grant received in advance	£181	£50	£100	£100
Sub-total	**£287**	**£142**	**£140**	**£150**
Short term cash / working capital	£150	£25	£25	£25
Total	**£437**	**£167**	**£165**	**£175**

The level of core funds available beyond 2022/23 will remain reasonably constant until 2027/28 when (as illustrated in Indicator 7) £22m of borrowing is due to be repaid.

Investment greater than 365 days	2021/22 Forecast £m	2022/23 Estimate £m	2023/24 Estimate £m	2024/25 Estimate £m
Maximum - end of the year	£140	£150	£150	£150
Existing long term investments	£40	£40	£15	£10
Balance available to invest	**£100**	**£110**	**£135**	**£140**

The table above shows the estimated amount available to invest in longer term investments of more than 365 days duration based on the estimated level of core funds available (excluding short term cash and working capital) measured against the existing longer term investment portfolio as at the end of December 2021.

It shows that some significant capacity remains for further longer term investments in the next three years due to the substantial balance on capital grants received in advance (£250m as at 31 December 2021). Even after forecast capital expenditure of £69m in 2021/22, the balance carried forward will be c.£181m.

Table 3 - Target return on investments (Yield)

Using the prospects for interest rates, returns on longer term investments and core funds available to investment set out above, the target return on the investment portfolio as a whole (short and long term) is as follows:

Returns on investments	2021/22 Forecast %	2022/23 Estimate %	2023/24 Estimate %	2024/25 Estimate %
Target return on treasury investments	0.37%	0.70%	0.70%	0.70%

Security

The risk of default varies according to the type of investment. Local authorities are assumed to have a zero default rate. The default risk attached to other counterparties depends on their creditworthiness and duration of investment. The MCA's treasury advisors provide historic default rates for different types of counterparty as a guide. The risk of default on non local authority investments in the investment portfolio as at March 2021 using historic default rates provided by the MCA's treasury advisors at the end of 2020/21 is c. 0.012% or £7k.

This is considered an acceptable level of risk against an average portfolio of £418m.

Liquidity

A balance of £25m will be maintained in highly liquid instant access investments / the bank to manage day to day treasury activity.

Creditworthiness policy

The MCA has adopted the creditworthiness service provided by its external treasury management advisors to manage counterparty risk.

The service involves a risk weighted scoring of the three main credit rating agencies to arrive at a colour coding system to recommend the maximum duration of investments. This is summarised in the table below:

Colour Band	Duration
Yellow	5 years *
Dark pink	5 years for Ultra Short Dated Bond Funds with a credit score of 1.25
Light pink	5 years for Ultra Short Dated Bond Funds with a credit score of 1.5
Purple	2 years
Blue	1 year (only applies to nationalised/semi nationalised UK Banks)
Orange	1 year
Red	6 months
Green	100 days
No colour	not to be used

The Lending limits (amounts and duration) for each counterparty are unchanged from 2021/22.

At the foot of the matrix table, other investment options have been introduced. These include, for example, short dated bond funds, property funds and multi asset income funds. No limits have been specified for these new investment types as yet, subject to further investigation into the risks and suitability of these options.

Table 4 - Lending Limits

	Colour (and long term rating where applicable)	Maximum sum and/or % Limit (per institution)	Time Limit
Banks *	Yellow	100%	5 years
Banks	Purple	£30m	2 years
Banks	Orange	£30m	1 year
Banks – part nationalised**	Blue	£50m	1 year
Banks (UK Banks)	Red	£20m	6 months
Banks (non-UK Banks)	Red	£15m	6 months
Banks	Green	£10m	100 days
Banks	No colour	Not to be used	

	Colour (and long term rating where applicable)	Maximum sum and/or % Limit (per institution)	Time Limit
MCA's banker (Barclays) in the event of the bank being 'no colour'	-	100 %	5 days***
DMADF	AAA	100%	6 months
Local authorities and other suitable public bodies or bodies delivering public services funded by the government	N/A	£50m	10 years
Money market funds – CNAV ****	AAA	100 %	Liquid
Money market funds – LVNAV *****	AAA	100 %	Liquid
Money market funds – VNAV ******	AAA	100 %	Liquid
Ultra short dated bond funds with a credit score of 1.25	Dark pink / AAA	100 %	Liquid
Ultra short dated bond funds with a credit score of 1.5	Light pink / AAA	100 %	Liquid
Short dated bond funds			
Property Funds			
Multi Income Asset Funds			

** Please note: the yellow colour category is for UK Government debt, or its equivalent, constant net asset value money market funds and collateralised deposits where the collateral is UK Government debt.*
*** When placing deposits with part nationalised banks the MCA will take care to review when it expects the UK Government to divest its interest in the institution, and the impact this move would have on the MCA's view of the institutions security.*
**** to cover period to next working day allowing weekends and bank holidays such as Easter*
***** CNAV refers to Constant Net Asset Value Money Market Funds when investors will be able to purchase and redeem at a constant Net Asset Value (£1 in / £1 out)*
****** LVNAV refers to Low Volatility Net Asset Value Money Market Funds when investors will be able to purchase and redeem at a stable Net Asset Value to two decimal places, provided the fund is managed to certain restrictions*
******* VNAV refers to Variable Net Asset Value Money Market Funds where the price may vary*

The MCA is alerted to changes to ratings through the creditworthiness service provided by its external treasury advisors.
If a downgrade results in the counterparty / investment scheme no longer meeting the MCA's minimum criteria, its further use as a new investment will be withdrawn immediately. Any existing investment will be redeemed as soon as it is economically viable.
Investment instruments identified for use in the financial year are listed under the 'specified' and 'non-specified' investments categories. Counterparty limits will be as set through the MCA's treasury management practices.

Country limits

The MCA has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of "AA-" from Fitch. The list of countries that qualify using this credit criteria as at the date of this report are as shown below. Should ratings change, this list will be added to, or deducted from, by officers in accordance with this policy.

AAA

- Australia
- Denmark
- Germany
- Luxembourg

- Netherlands
- Norway
- Singapore
- Sweden
- Switzerland

AA+
- Canada
- Finland
- U.S.A.

AA
- Abu Dhabi (UAE)
- France

AA-
- Belgium
- Hong Kong
- Qatar
- **U.K.**

Specified and Non specified investments
The distinction between specified and non specified investments is important because of the additional procedures that need to be undertaken in considering the risk attached to non specified investments.

Specified Investments
Statutory Guidance on Investments defines specified investments as ones having the following characteristics:
- Denominated in sterling
- The duration is 12 months or less
- The investment is high quality or is with the UK Government or a local authority

High quality is determined by reference to the matrix table included in the creditworthiness policy.

Table 5 - Limits on Specified Investments

	Minimum credit criteria / colour band	** Max % of total investments / £ limit per institution	Max. maturity period
Money Market Funds CNAV	AAA	100%	Liquid
Money Market Funds LNVAV	AAA	100%	Liquid
Money Market Funds VNAV	AAA	100%	Liquid
Ultra-Short Dated Bond Funds with a credit score of 1.25	AAA	100%	Liquid

	Minimum credit criteria / colour band	** Max % of total investments / £ limit per institution	Max. maturity period
Ultra-Short Dated Bond Funds with a credit score of 1.5	AAA	100%	Liquid
Local authorities	yellow	100%	12 months
Term deposits with banks and building societies or housing associations	Blue Orange Red Green No Colour	As per lending limits table	12 months 12 months 6 months 100 days Not for use
CDs or corporate bonds with banks and building societies	Blue Orange Red Green No Colour	As per lending limits table	12 months 12 months 6 months 100 days Not for use
UK government debt	Yellow	100%	12 months

Non specified investments
These are any investments which do not meet the specified investment criteria.
As far as the MCA is concerned, Non-specified investments represent those with a duration of more thanone year, and/or are more complex instruments which require greater consideration by members and officers before being authorised for use.

The table below illustrates the types of non specified investment that are currently being invested in orcould be considered at a future date. The list is not however intended to be exhaustive and may be expanded as other types of investment are investigated.

Table 6 - Limits on Non Specified Investments

Duration of more than one year	* Minimum Credit Criteria	** Max % of total investments	Max. maturity period
Term deposits – local authorities	N/A	100%	10 years
Term deposits – banks and building societies	Purple	£30m	2 years
UK Government Debt	Yellow	100%	5 years
Multi asset income funds			
Property Funds			
Short dated bond funds			