Appendix A

South Yorkshire Mayoral Combined Authority

2023/24 Treasury Management Strategy Statement

Minimum Revenue Provision Policy Statement and Annual Investment Strategy

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1 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 currenteconomic 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 2023/24 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,the CIPFA Treasury Management Code, MHCLG MRP Guidance and MHCLG Investment Guidance. The requirements of the updated Treasury Management and Prudential Codes on 20th December 2021 are provided in more detail in the next section – Background.

The Annual Treasury Management Strategy is the first of a minimum of five reports that will be reported in respect of 2023/24 treasury activity. As a minimum the four other reports will comprise:

- three quarterly reports (a new requirement of the 2021 Treasury Management Code) which will provide an update on treasury activity for the first 9 months of the 2023/24 financial year; and
- an annual report which will provide actual performance against the treasury management strategy after the end of the 2023/24 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.

Recommendations (for the MCA Board in March 2023)

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 Executive Director of Resources and Investment in consultation with the Chief Executive to provide a financial guarantee in favour of the SCR Financial Interventions Holding company; and
- Support the intention to negotiate with HM Treasury and DLUHC to agree a borrowing cap for all MCA functions (transport & non-transport) for 2023/24.

2 Background

The MCA is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. Part of the treasury management operation is to ensure that this 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 appetite, providing adequate liquidity initially before considering investment return.

The second main function of the treasury management service is the funding of the Authority's capital plans. These capital plans provide a guide to the borrowing need of the Authority, essentially the longer-term cash flow planning, to ensure that it 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. On occasion, when it is prudent and economic, any debt previously drawn may be restructured to meet risk or cost objectives.

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 for 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 of the sums invested, as a loss of principal will in effect result in a loss to the General Fund Balance.

CIPFA defines treasury management as:

"The management of the local authority's borrowing, investments and cash flows, including its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."

2021 Revised CIPFA Treasury Management Code and Prudential Code Changes

CIPFA published the revised Codes on 20 December 2021 and has stated that revisions need to be included in the reporting framework from the 2023/24 financial year. This Authority, therefore, has to have regard to these Codes of Practice when it prepares the Treasury Management Strategy Statement and Annual Investment Strategy, and also related reports during the financial year, which are taken to the MCA Board for approval.

The revised Treasury Management Code requires all investments and investment income to be attributed to one of the following three purposes: -

<u>Treasury Management</u>
Arising from the organisation's cash flows or treasury risk management activity, this type of investment represents balances which are only held until the cash is required for use.

<u>Service Delivery</u>
Investments held primarily and directly for the delivery of public services including housing, regeneration and local infrastructure. Returns on this category of investment which are funded by borrowing are permitted only in cases where the income is "either related to the financial viability of the project in question or otherwise incidental to the primary purpose".

<u>Commercial Return</u>
Investments held primarily for financial return with no treasury management or direct service provision purpose. Risks on such investments should be proportionate to an authority's financial capacity – i.e. that 'plausible losses' could be absorbed in budgets or reserves without unmanageable detriment to local services. The MCA does not hold, or intend to hold, any commercial investments.

The revised Treasury Management Code will require an authority to implement the following: -

- **Adopt a new debt liability benchmark treasury indicator** to support the financing risk management of the capital financing requirement; this is to be shown in chart form for a

minimum of three years, with material differences between the liability benchmark and actual loans to be explained;

- **Long-term treasury investments**, (including pooled funds), are to be classed as commercial investments unless justified by a cash flow business case;

- **Pooled funds** are to be included in the indicator for principal sums maturing in years beyond the initial budget year;

- Amendment to the **knowledge and skills register** for officers and members involved in the treasury management function - to be proportionate to the size and complexity of the treasury management conducted by each authority;

- **Reporting to members is to be done quarterly.** Specifically, the Chief Finance Officer (CFO) is required to establish procedures to monitor and report performance against all forward-looking prudential indicators at least quarterly. The CFO is expected to establish a measurement and reporting process that highlights significant actual or forecast deviations from the approved indicators; and

- **Environmental, social and governance (ESG)** issues to be addressed within an authority's treasury management policies and practices (TMP1).

The main requirements of the Prudential Code relating to service and commercial investments are: -

- The risks associated with service and commercial investments should be proportionate to their financial capacity – i.e. that plausible losses could be absorbed in budgets or reserves without unmanageable detriment to local services;

- An Authority must <u>not</u> borrow to invest for the primary purpose of commercial return;

- It is not prudent for local authorities to make any investment or spending decision that will increase the CFR, and so may lead to new borrowing, unless directly and primarily related to the functions of the authority, and where any commercial returns are either related to the financial viability of the project in question or otherwise incidental to the primary purpose;

- An annual review should be conducted to evaluate whether commercial investments should be sold to release funds to finance new capital expenditure or refinance maturing debt;

- A prudential indicator is required for the net income from commercial and service investments as a proportion of the net revenue stream; and

- Create new Investment Management Practices to manage risks associated with non-treasury investments (similar to the current Treasury Management Practices).

Economic Background – Summary

Against a backdrop of stubborn inflationary pressures, the easing of Covid restrictions in most developed economies, the Russian invasion of Ukraine, and a range of different UK Government policies, UK interest rates have been volatile from the base rate through to 50-year gilt yields, for all of 2022. The UK base rate was increased to 3.5% in December 2022 which represents a rise of 3.4% since December 2021. Forecasted UK rates are shown in Table 1 p18.

This has also been a global phenomenon. In December, the US Fed decided to push up rates by 0.5% to a range of 4.25% to 4.5% and Eurozone rates have also increased to 2% with further tightening in the pipeline.

In addition, the £ has strengthened of late, recovering from a record low of $1.035, on the Monday following the Truss government's "fiscal event", to $1.22 (10 January 2023).

Borrowing Strategy

In early 2022 the MCA received approval from the Government to borrow money for non-transport purposes, thus complementing its existing powers to borrow for transport purposes. At the same time the MCA agreed with HM Treasury to a new borrowing cap (as required by the new legislation) of £170.8m in 2022/23. However, no new borrowing has been taken to date, and the MCA is in the process of agreeing a new cap with the Government for 2023/24.

Our borrowing strategy will remain draft until the new cap has been approved and the MCA's emerging investment strategy firmed up. As such, at this stage, it will follow the same borrowing strategy as previous years namely: 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.

In addition, the draft 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 (i.e. £50m of debt that matures in 2023/24).

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 the government in November 2020 and latterly by the 2021 Prudential Code 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 and do not fall within the definition of commercial investment assets under the Statutory Guidance.

Capital Expenditure Plans and Prudential Indicators: 2023/24 to 2026/27

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:

Group Capital Expenditure Estimates	2022/23	2023/24	2024/25	2025/26
	Forecast	Estimate	Estimate	Estimate
	£m	£m	£m	£m
Total Capital Investment	**£158**	**£153**	**£tbc**	**£tbc**

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.

Group Capital Financing Estimates	2022/23	2023/24	2024/25	2025/26
	Forecast	Estimate	Estimate	Estimate
	£m	£m	£m	£m
Total capital investment	£158	£153	£tbc	£tbc
Total capital funding	**£158**	**£153**	**£tbc**	**£tbc**
Net borrowing needed for the year	**£0**	**£0**	**£0**	**£0**

Based on the above draft 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 shown in the following table. This includes the Doncaster PFI scheme under Other Long Term Liabilities (OLTL) from 2023/24 in accordance with Local Government criteria as the PTE will formally dissolve as an entity as at 31 March 2023.

Group Capital Financing Requirement	2022/23	2023/24		2024/25		2025/26	
	Forecast	Estimate		Estimate		Estimate	
	Loans	Loans	OLTL	Loans	OLTL	Loans	OLTL
	£m	£m	£m	£m	£m	£m	£m
Opening CFR	**£110**	**£107**		**£103**	**£10**	**£100**	**£10**
Opening adjustment - Doncaster Interchange PFI			£10				
Implementation of IFRS 16					£0		

movement in CFR							
Additional borrowing requirement	£0	£0		£0		£0	
MRP	-£3	-£3	-£0	-£3	-£0	-£3	-£0
Capital receipts set aside for the repayment of debt	£0	£0		£0		£0	
Other adjustments	£0	£0		£0		£0	
Closing CFR	**£107**	**£103**	**£10**	**£100**	**£10**	**£96**	**£9**

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	2022/23	2023/24		2024/25		2025/26	
	Forecast	Estimate		Estimate		Estimate	
	Loans	Loans	OLTL	Loans	OLTL	Loans	OLTL
	£m	£m	£m	£m	£m	£m	£m
MCA Loans - start of the year	£25	£25		£21		£17	
Expected change in MCA Loans	£0	-£4		-£4		-£4	
SYPTE Debt - start of the year	£100	£92		£46		£46	
Expected change in SYPTE Debt	-£8	-£46		£0		£0	
Doncaster Interchange PFI - start of the year			£10		£10		£10
Expected change in PFI liability			-£0		-£0		-£0
Implementation of IFRS 16					£0		
Gross Debt - end of the year	**£117**	**£67**	**£10**	**£63**	**£10**	**£59**	**£9**
Capital Financing Requirement	£107	£103	£10	£100	£10	£96	£9
Gross Debt in excess of / (less than) CFR	**£11**	**-£36**	**£0**	**-£37**	**£0**	**-£37**	**£0**

Historically, gross debt has exceeded CFR because MRP has been charged annually to the Transport Levy to write down the CFR but no significant loan repayments had taken place. As illustrated in the table above, the MCA's borrowing position will be in line with CIPFA guidance in 2023/24 when £50m of debt will be repaid.

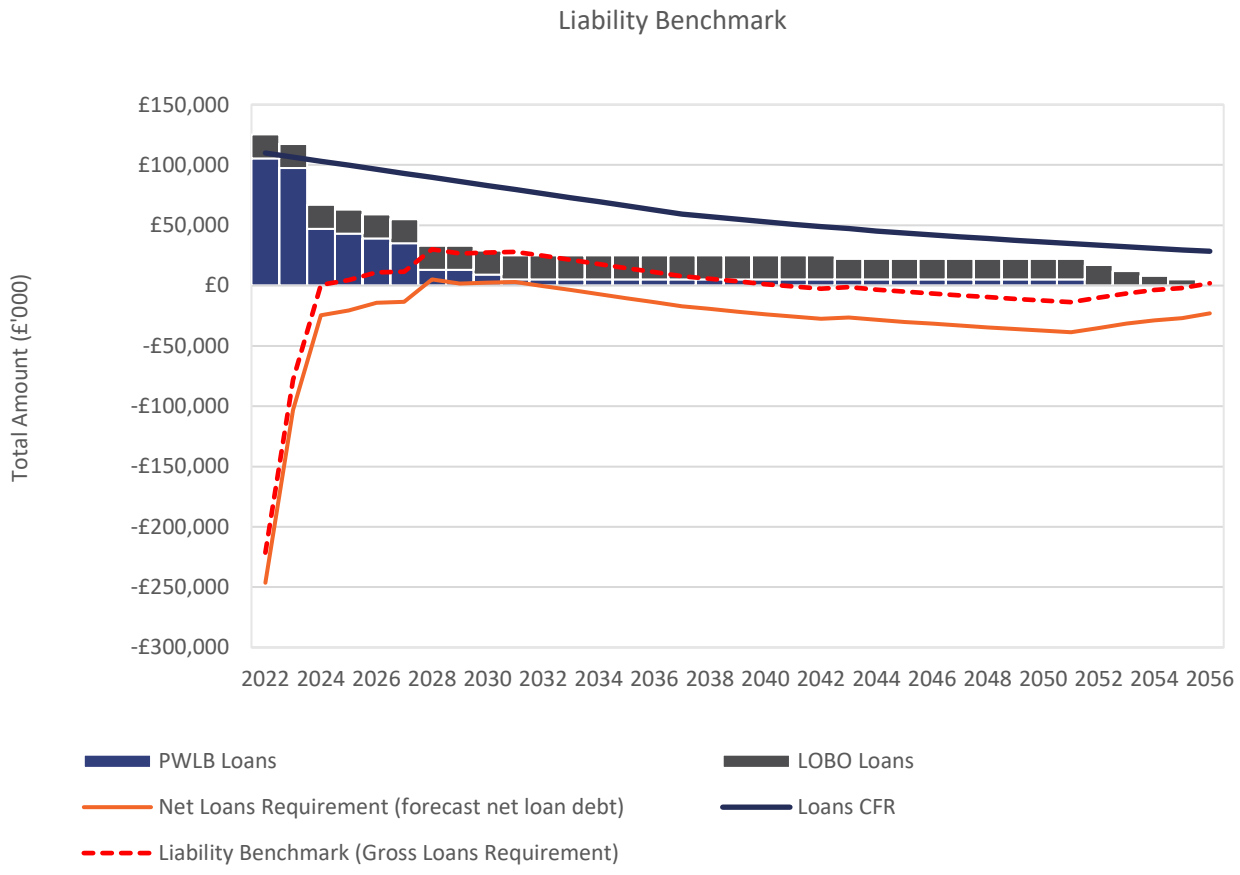
The repayment of borrowing is also drawing down on the cash investments built up in previous years for the repayment of debt with the consequence that the level of investments is also forecast to fall - see Investment Strategy - Table 2.

Indicator 4 - Liability Benchmark

A new prudential indicator for 2023/24 is the Liability Benchmark. The Authority is required to estimate and measure the Liability Benchmark for the forthcoming financial year and the following two financial years, as a minimum. *(nb: it is intended to extend this to 10 years as part of developing this benchmark over the course of 2023/24).*

There are four components to the Liability Benchmark: -

1. **Existing loan debt outstanding**: the Authority's existing loans that are still outstanding in future years.
2. **Loans CFR**: this is calculated in accordance with the loans CFR definition in the Prudential Code and projected into the future based on approved prudential borrowing and planned MRP.
3. **Net loans requirement**: this will show the Authority's gross loan debt less treasury management investments at the last financial year-end, projected into the future and based on its approved prudential borrowing, planned MRP and any other major cash flows forecast.
4. **Liability benchmark** (or gross loans requirement): this equals net loans requirement plus short-term liquidity allowance.



The purpose of the Liability Benchmark is to present pictorially, how the authority's existing loans outstanding (the black line) compare against its future need for loan debt, or liability benchmark (the broken red line). If the black line is below the broken red line, the existing portfolio outstanding is less than the loan debt required, and the authority will need to borrow to meet the shortfall. If the black line is above the broken red line, the authority will (based on its current plans) have more debt than it needs, and the excess can be invested.

The chart above shows that the MCA will have existing loans outstanding in excess of future need for loan debt over the next 3 financial years, and that therefore there is surplus cash available for investment.

The solid red line represents the net loan requirement. This is below the liability benchmark (broken red line) because the liability benchmark makes allowance for a liquidity buffer of £25m – an estimate of the level of

short-term investments needed to provide an adequate (but not excessive) level of liquidity for daily cash flow management currently held in Money Market Funds / Cash at Bank.

Indicator 5 - 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	2022/23	2023/24	2024/25	2025/26
	Forecast	Estimate	Estimate	Estimate
	£m	£m	£m	£m
Interest	£8	£5	£4	£4
MRP	£3	£4	£4	£4
Financing Costs	**£11**	**£9**	**£8**	**£8**
Income - transport levy	£54	£55	£55	£55
Other unrestricted income	£21	£20	£18	£18
Net Revenue Stream	**£76**	**£75**	**£73**	**£73**
Finance Costs/net Revenue Stream	15%	12%	11%	10%

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. Investment income will fall to reflect 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. This position is partially mitigated by a rising interest rate environment which should generate higher returns from the remaining core investments.

External Debt – borrowing limits – Indicators 6 and 7

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	2022/23	2023/24	2024/25	2025/26
	Forecast	Estimate	Estimate	Estimate
	£m	£m	£m	£m
Loans	£665	£132	£82	£78
Headroom for potential new borrowing		£50	£50	£50
Other Long Term Liabilities	£11	£11	£10	£10
Total	**£676**	**£193**	**£142**	**£138**

Operational Boundary	2022/23 Forecast £m	2023/24 Estimate £m	2024/25 Estimate £m	2025/26 Estimate £m
Loans	£650	£117	£67	£63
Headroom for potential new borrowing		£50	£50	£50
Other Long Term Liabilities	£11	£11	£10	£10
Total	**£661**	**£178**	**£127**	**£123**

In the current financial year the authorised limit and operational boundary was adjusted to reflect the receipt of both borrowing powers and the long-term financial commitment made through the South Yorkshire Devolution Deal.

These powers and resource could have enabled the region to afford to borrow upwards of £0.5bn. Accordingly, the limits in this indicator were set to this level to provide sufficient scope to take on a sizeable amount of borrowing.

Since this point, however, more work has been undertaken on the region's investment strategy, particularly around practicalities of how resource would be dispersed amongst the MCA's five constituent authorities and who and how borrowing may be taken to finance up-front investment.

This work has led to much more conservative assumptions being made for the MCA's authorised limit and operational boundaries. The authorised limit is adjusted this year to accommodate £50m of investment headroom on top of the existing debt. This level of headroom would accommodate investment that the MCA itself may wish to finance in the immediate term through borrowing. This borrowing would be repaid through the MCA's gainshare allocation.

The other constituent authorities of the MCA are likely to have adjusted their own indicators to reflect that they could take on borrowing that would be repaid through their own individual gainshare allocations.

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

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 2024/25. However, finance officers have assessed the impact of IFRS16, and it is not expected thatany other long-term liabilities will need to be brought on balance sheet on 1 April 2024.

Indicator 8 – 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	%
2022/23	8	7%
2023/24	50	40%
2024/25	4	3%
2025/26	4	3%
2026/27	4	3%
2027/28	22	18%
2028/29	0	0%
2029/30	4	3%
2030/31	4	3%

2043 to 2056	25	20%
Total	**£125**	**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 is based on the position set out in Indicator 2:
- The need to repay Market loans will not be necessary. This has previously been considered very unlikely but as the base rate increases this becomes more probable (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 4.5% to 5%. Whilst, rate have increased, these are still lower than rates on the Group's existing PWLB debt portfolio which are up 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 prevailing rates are getting ever closer to market loan rates, there is an increased chance that the lender will exercise their call option which would require the MCA to refinance it.

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 MCA's capital programme. The company does not trade, is controlled by the MCA's Executive Leadership Board 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 2023/24 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 Executive Director of Resources and Investment to enter into any borrowing, investment and financing arrangements on behalf of the Authority compliant with the TreasuryManagement Policy, it is recommended that delegated authority be given to the Executive Director of Resources and Investment to provide the financial guarantee on the MCA's behalf for filing with Companies House.

Use of External Advisors

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

The MCA also has a service level agreement with Sheffield City Council to provide treasury services including managing the MCA's investment portfolio on its behalf. **NB**: Banking was brought in-house during 2022/23.

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.

The MCA is recommended to approve the following MRP statement for financial year 2023/24:
MRP on the residual Capital Financing Requirement at the end of 2015/16 relating to capital expenditure incurred before 1 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 1 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 qualifiedprofessional 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 use borrowing 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 to repay debt in lieu of charging revenue.

Members are asked to note the consultation on MRP changes, the results of which have not yet been received. The draft proposals on this consultation may preclude the use of capital grant in-lieu of charging revenue. The MCA has engaged 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:

- The 2021 Treasury Management Code;
- MHCLG's Guidance on Local Government Investments; and
- CIPFA Treasury Management in the Public Services Guidance Notes 2021.

The MCA's investment priorities will be security, portfolio liquidity second and yield (return) in that priority order. The MCAwill 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.

As mentioned in the Background section, changes to the 2021 Treasury Management Code require the MCA to incorporate Environmental Social and Governance (ESG) criteria into its Investment Strategy from 2023/24 – specifically in its Treasury Management Practice 1. The Code recognises that this is a developing area for public sector organisations as there are a diversity of market approaches to ESG classifications. As such and within this context, the requirement is for a broad policy statement at this stage rather than to include ESG scoring or other real-time ESG criteria at individual investment level.

DLUHC and CIPFA place a high priority on the management of risk. Accordingly, the MCA has adopteda 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.

    1. **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.
    2. **Non-specified investments** are those with less high credit quality, maybe 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

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.

However, as interest rate predictions from Link predict a peak of 4.5% before falling in March 2024 (see table below) investments in alternative or longer-term options will be considered to ensure the best possible returns without jeopardising security or liquidity. Options that may be considered include:-

- 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 may create more risk than more 'vanilla' investment options. 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.

Investment Performance

Over the course of 2022/23 in the 9 months to December 2022, the average size of the investment portfolio was £453m with the weighted average return on investments averaging 1.45% - an increase of 0.72% on the April 2022 figure of 0.73%.

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.

Table 1 - Prospects for Interest Rates

Link Group Interest Rate View	19.12.22												
	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25
BANK RATE	3.50	4.25	4.50	4.50	4.50	4.00	3.75	3.50	3.25	3.00	2.75	2.50	2.50
3 month ave earnings	3.60	4.30	4.50	4.50	4.50	4.00	3.80	3.30	3.00	3.00	2.80	2.50	2.50
6 month ave earnings	4.20	4.50	4.60	4.50	4.20	4.10	3.90	3.40	3.10	3.00	2.90	2.60	2.60
12 month ave earnings	4.70	4.70	4.70	4.50	4.30	4.20	4.00	3.50	3.20	3.10	3.00	2.70	2.70
5 yr PWLB	4.20	4.20	4.20	4.10	4.00	3.90	3.80	3.60	3.50	3.40	3.30	3.20	3.10
10 yr PWLB	4.30	4.40	4.40	4.30	4.10	4.00	3.90	3.80	3.60	3.50	3.40	3.30	3.30
25 yr PWLB	4.60	4.60	4.60	4.50	4.40	4.20	4.10	4.00	3.90	3.70	3.60	3.50	3.50
50 yr PWLB	4.30	4.30	4.30	4.20	4.10	3.90	3.80	3.70	3.60	3.50	3.30	3.20	3.20

As mentioned and shown in Table above, the Bank Rate is expected to increase to 4.50% by summer 2023 before falling in March 2024 as the Bank of England takes action to counter the threat of inflation. During this period, the UK is expected to fall into a prolonged period of recession, albeit relatively shallow.

PWLB interest rates on borrowing are expected to peak to between 4.2% to 4.6% (depending upon the term of the loan) in summer 2023 but fall to a range 3.1% and 3.5% in 3 years' time.

Table 2 - Core Funds and Balances and Longer Term Investments of More Than 365 days

Core Funds	2022/23 Forecast £m	2023/24 Estimate £m	2024/25 Estimate £m	2025/26 Estimate £m
Reserves and balances - revenue and capital	£107	£75	£72	£66
-Under/Over borrowed position	£11	-£36	-£37	-£37
Capital grant received in advance	£100	£100	£100	£100
Sub-total	**£218**	**£139**	**£135**	**£129**
Short term cash / working capital	£15	£15	£15	£15
Total	**£233**	**£154**	**£150**	**£144**

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	2022/23 Forecast £m	2023/24 Estimate £m	2024/25 Estimate £m	2025/26 Estimate £m
Maximum - end of the year	£150	£144	£143	£124
Existing long term investments	£73	£33	£0	£0
Balance available to invest	**£77**	**£111**	**£143**	**£124**

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 2022.

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, even after forecast capital expenditure of £158m in 2022/23 – see Table 2 above.

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%	2.62%	2.18%	1.99%

NB: the target is based on gross investment returns but does not take into account running down investments to cover off maturing debt.

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 2022 using historic default rates provided by the MCA's treasury advisors at the end of 2021/22 is c. 0.012% or £9k.

This is considered an acceptable level of risk against an average portfolio of £453m.

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 managementadvisors 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 2022/23 except to increase the limit on UK banks for 6 month terms from £20m to £40m. This is based on 10% of the average investment balance over the past 2 years. The change reflects the increased level of available funding that the Authority now has to deal with alongside a reducing scope to place investments due to factors such as creditworthiness.

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**	£40m	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	TBD	TBD	TBD

** 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
- **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 investments 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

NB: The Authority will review the limits for other 'non specified' investments such Short dated bond funds/ Property Funds/ Multi Income Asset Funds as during 2023/24