NOTTINGHAMSHIRE
Fire & Rescue Service
Creating Safer Communities

Nottinghamshire and City of Nottingham
Fire and Rescue Authority

TREASURY MANAGEMENT STRATEGY 2023/24

Report of the Treasurer to the Fire Authority

Date: 24 February 2023

Purpose of Report:

To seek the approval of Members for the proposed Treasury Management Strategy for 2023/24, the Policy on Environmental, Social and Governance and the Authority's Minimum Revenue Provision Policy for 2023/24.

Recommendations:

It is recommended that Members approve:

- The Treasury Management Strategy for 2023/24.
- The policy on Environmental, Social and Governance (ESG) considerations.
- The Minimum Revenue Provision Policy for 2023/24.

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1. BACKGROUND

1.1 The Local Government Act 2003 requires the Authority to set out its treasury strategy for borrowing and to prepare an annual investment strategy; this sets out the Authority's policies for borrowing, for managing its investments and for giving priority to the security and liquidity of those investments.

1.2 The Authority 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 needed. Surplus monies are invested in low-risk counterparties or instruments commensurate with the Authority's low risk appetite, ensuring adequate security and liquidity before considering investment return.

1.3 The second main function of the treasury management operation 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 the Authority can meet its capital spending obligations. The management of longer-term cash may involve arranging long or short-term loans or using longer-term cash flow surpluses.

1.4 Treasury management is defined by CIPFA as *"the management of the local authority's borrowing, investments and cash flows, 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*." The treasury management function makes an important contribution to the Authority, as the balance of debt and investment operations ensures the ability to meet spending commitments as they fall due, either on day-to-day revenue or on larger capital projects. The treasury operations will see a balance of the interest costs of debt and the investment income arising from cash deposits affecting the available budget. Since cash balances generally result from reserves, it is paramount to ensure the adequate security of sums invested, as the loss of principal will in effect result in a loss to the General Fund Balance.

1.5 The Authority adopted the CIPFA Treasury Management in the Public Services Code of Practice and Cross-Sectoral Guidance Notes 2009 (the Code) on 9 April 2010. It has subsequently been updated, with the most recent revision being published in December 2021. Many of the changes in the revised Code are concerned with commercial and service investment practices and so will have a limited impact on the Authority. Other changes include:

1. A requirement for the Authority to adopt a new debt liability benchmark treasury indicator to support the financing risk management of the capital financing requirement. Details of this indicator can be found in the separate report on the Prudential Code for Capital Finance, also on the agenda.

2. Ensuring that any long-term treasury investment is supported by a business case.

3. An amendment to Treasury Management Practice (TMP) 1 to address Environment, Social and Governance policy within the treasury management risk framework.

4. An amendment to the knowledge and skills register for individuals involved in the treasury management function.

1.6 The 2021 edition of the Code recommends that the following clauses are adopted by public service organisations prior to the 2023/24 financial year as part of their financial regulations or other formal policy documents:

1. The creation and maintenance of a Treasury Management Policy Statement which sets out the policies, objectives and approach to risk management of the Authority's treasury management activities (see Appendix A).

2. The creation and maintenance of suitable Treasury Management Practices (TMPs) which set out the manner in which the Authority will seek to achieve those policies and objectives and prescribing how it will manage and control these activities.

3. The creation and maintenance of suitable investment management practices for any investments that are not for treasury management purposes.

4. Delegation by the Authority of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions. This Authority delegates the role of scrutinising the treasury management strategy and policies to the Finance and Resources Committee.

5. Receipt by the Fire Authority of an annual Treasury Management Strategy Statement for the year ahead, a mid-year review report and an annual report covering activities during the previous year. Members of the Finance and Resources Committee will receive a quarterly monitoring report comprised of updated Treasury/Prudential Indicators.

6. This Authority nominates the Treasurer to be responsible for ensuring effective scrutiny of the treasury management strategy and policies.

1.7 The Authority's Financial Regulations and Treasury Management Practices are currently under review and will be updated to reflect the clauses identified in 1.5 and 1.6. In practical terms the clauses have already been built into treasury management procedures.

1.8 A report on the Prudential Code for Capital Finance is also on this agenda. This report sets out the prudential indicators for 2023/24, which are designed to ensure that the Authority's capital investment plans are affordable, prudent and sustainable and are in accordance with CIPFA's Prudential Code. The Prudential Code was revised in December 2021. One of the key changes in the 2021 edition of the Prudential Code is the explicitly stated requirement that authorities must not borrow to invest primarily for financial return. The Prudential Code includes a requirement to prepare a Capital Strategy – this was approved as part of the Medium Term Financial Strategy by Fire Authority on 16 December 2022.

1.9 This Treasury Management Strategy report is complementary to the Prudential Code report and the proposed prudential and treasury limits for 2023/24 are included in both reports for completeness.

1.10 This report also sets out the Authority's Minimum Revenue Provision policy for 2023/24 for approval by Members in paragraphs 2.53 to 2.57.

1.11 The Authority has appointed Link Asset Services as its external treasury management adviser. Link Asset Services has provided the Authority with its view on the economic outlook and on anticipated interest rates for the forthcoming year.

2. REPORT

TREASURY MANAGEMENT STRATEGY FOR 2023/24

2.1 The Local Government Act 2003 (the Act) and supporting regulations requires the Authority to 'have regard to' the CIPFA Prudential Code and the CIPFA Treasury Management Code of Practice to set Prudential and Treasury Indicators for the next three years to ensure that the Authority's capital investment plans are affordable, prudent and sustainable.

2.2 The Act therefore requires the Authority to set out its treasury strategy for borrowing and to prepare an annual investment strategy: this sets out the Authority's policies for managing its investments and for giving priority to the security and liquidity of those investments.

2.3 The suggested strategy for 2023/24 in respect of the following aspects of the treasury management function is based upon Officers' views on interest rates, supplemented with leading market forecasts provided by the Authority's treasury adviser, Link Asset Services.

2.4 The strategy covers:

- Prudential and treasury indicators;
- The borrowing requirement;
- Prospects for interest rates;
- The borrowing strategy;
- Policy on borrowing in advance of need;
- Debt rescheduling;
- The investment strategy;

- Creditworthiness policy;
- Policy on use of external service providers;
- The Minimum Revenue Provision policy;
- Training of Officers and Members.

2.5 The Authority recognises that whilst there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources, responsibility for treasury management decisions remains with the organisation at all times. The Authority will therefore ensure that undue reliance is not placed upon external service providers.

BALANCED BUDGET REQUIREMENT

2.6 It is a statutory requirement under Section 32 of the Local Government Finance Act 1992 for the Authority to produce a balanced budget. A local authority must calculate its budget requirement for each financial year to include the revenue costs that flow from capital financing decisions. This includes a statutory requirement to make a prudent provision for an annual contribution from its revenue budget towards the reduction in its overall borrowing requirement. This charge is known as the Minimum Revenue Provision (MRP). This means that increases in capital expenditure must be limited to a level whereby increases in the following charges to revenue remain affordable within the projected income of the Authority for the foreseeable future:

- Increases in interest charges caused by increased borrowing to finance additional capital expenditure;

- Any increases in running costs from new capital projects, and

- Any increases in the Minimum Revenue Provision.

ECONOMIC BACKGROUND

2.7 UK inflation reached a 40 year high during 2022, with the annual CPI rate peaking at 11.1% in October. This surge in inflation has been caused largely by increased demand resulting from the lifting of pandemic restrictions, and by the Russian invasion of Ukraine which has impacted both energy and food prices. In December the Bank of England reported that it expected inflation to fall from the middle of 2023, as previous increases in energy prices drop out of the comparison and there is less demand for goods and services in the UK. The CPI rate for December was 10.5%.

2.8 The Bank of England base rate has increased from 0.25% in January 2022 to 3.50% in December in response to the increase in inflation. The market expects bank rate to hit 4.5% by May 2023.

2.9 In its latest bulletin the Office of National Statistics reported that UK GDP fell by 0.3% in the three months to November 2022, although the additional bank holiday due to the death of the Queen will have had an impact. In November, the Bank of England's Monetary Policy Committee projected eight quarters of negative growth lasting throughout 2023 and 2024, but with the bank rate set to peak at lower levels than previously priced in by the markets and the fiscal tightening deferred to the next Parliament to some extent, it is not clear that things will be as bad as first anticipated by the Bank.

2.10 A more comprehensive economic summary prepared by Link Asset Services can be found at Appendix B

2.11 The latest interest forecasts from Link Asset Services can be found at Appendix C.

MANAGEMENT OF CASH RESOURCES

2.12 The Authority uses a main current account, an investment account and a petty cash account. All of these accounts are held with Barclays Bank PLC and are managed online. This system allows the Authority to make transfers to and from accounts in real time and thus allows the current account balance to be maintained at a minimum level. All surplus funds are held either in the investment account for short periods or are lent to institutional borrowers over longer periods.

2.13 The bank overdraft level is £200,000 and this is usually sufficient. There are occasions when the overdraft exceeds £200,000 and temporary arrangements are made with the bank to increase the limit to £500,000. The Prudential Code report included an overdraft limit of £500,000 within the authorised limit to allow for such instances. It is proposed that the day to day overdraft facility remains at a level of £200,000.

2.14 Part of the treasury management operation is to ensure that cash flows are adequately planned, with cash being available when it is needed. A 3 year cash flow projection is prepared together with a 3 month rolling cash flow forecast. The 3 month forecast is updated regularly and this process reveals when cash surpluses or shortages are likely to arise.

2.15 Cash management processes have been examined by internal auditors and have been shown to be robust.

BORROWING STRATEGY

2.16 The prudential indicators for borrowing are set out in Appendix D. Background information relating to these indicators is contained within the Prudential Code for Capital Finance 2023/24 report which is elsewhere on this agenda.

2.17 The capital financing requirement is the sum of money required from external sources to fund capital expenditure i.e. the Authority's underlying need to borrow or lease. For 2023/24 this figure is estimated at £30.646m. This figure is comprised of capital expenditure incurred historically by the Authority that has yet to be financed plus estimated capital expenditure and capital financing for 2022/23 and 2023/24.

2.18 The Authority's strategy in the past has been to borrow funds from the Public Works Loan Board (with the exception of a £4m bank loan which was taken in 2007/08). The PWLB is an agent of HM Treasury and its function is to lend money from the National Loans Fund to local authorities and other prescribed bodies. PWLB rates are set at a margin of 80 basis points above gilt yields. Officers will work with treasury advisors to carefully consider all funding options before undertaking any further long-term borrowing. The newly introduced Liability Benchmark indicator also provides a guide to the level and duration of borrowing that is required. Information about the Liability Benchmark can be found in the report on the Prudential Code for Capital Finance which is also on this agenda. The Authority will consider fixed rate market borrowing when rates are lower than PWLB rates. The Authority may also consider loans from the UK's Municipal Bond Agency and other local authorities.

2.19 The bank loan of £4m referred to in paragraph 2.18 is structured as a "Lender Option Borrower Option (LOBO)" loan. This means that on 7 March 2013 and on that anniversary every five years, the lender may revise the interest rate, which is currently 4.13%. The Authority may choose to repay the loan without penalty if the amended interest rate is not advantageous. If the lender does exercise the option to revise the interest rate, the strategy will be to either agree to continue the loan with the revised interest rate or to repay the loan and replace it with new, long-term debt at a lower rate depending on which is the most advantageous option for the Authority. The next opportunity for a revision of the interest rate is 7 March 2023. Based on current forecasts it is possible that the rate will be increased. If this were to happen it is likely that the loan would be repaid and refinanced by short-term borrowing until the medium to longer term interest rates reduce to a more affordable level (rates are currently expected to decrease steadily from September 2023 onwards).

2.20 Over the next four years, it is anticipated that the Authority will need to borrow up to £6.0m to finance the capital programme. The plan is to finance the repayment of maturing loans through a combination of capital funding surpluses (minimum revenue provision cash and capital receipts) and some of the advanced borrowing that was taken in 2021/22. However, any changes to planned expenditure and forecasted cash flows may require further borrowing to be taken in order to refinance maturing loans.

2.21 Link Asset Services' view on future PWLB interest rates is:

	Mar 23	**Jun 23**	**Sep 23**	**Dec 23**	**Mar 24**	**Mar 25**
5 yr PWLB	4.20%	4.20%	4.10%	4.00%	3.90%	3.40%
10 yr PWLB	4.40%	4.40%	4.30%	4.10%	4.00%	3.50%
25 yr PWLB	4.60%	4.60%	4.50%	4.40%	4.20%	3.70%
50 yr PWLB	4.30%	4.30%	4.20%	4.10%	3.90%	3.50%

The table above has been adjusted for the PWLB certainty rate, which is a 0.2% reduction in the interest rate for Authorities such as this one which have applied for it.

2.22 Since the start of 2022 there has been a lot of volatility in gilt yields, and hence PWLB rates. As the table above shows, there is forecast to be a steady but slow decrease in rates during the period from September 2023, though there will doubtless be a lot of unpredictable volatility during this forecast period making rates difficult to predict with any certainty.

2.23 In view of the above forecast the Authority's borrowing strategy will be based upon the following information.

- A combination of capital receipts, internal funds and borrowing will be used to finance capital expenditure in 2023/24 and beyond.

- Three PWLB loans will mature in during the next five years (£3m in 2023/24, £1m in 2026/27 and £1m in 2027/28). These repayments will need to be financed. It is estimated that total new borrowing in the period 2023/24 to 2027/28 will be in the region of £6.0m.

- Link Asset Services' view is that interest rates are likely to decline over the next three years, albeit slowly. It may therefore be advantageous to defer new loans where possible or to take short-term borrowing initially and then replace it with longer-term loans when rates become more favourable, as this will have a lesser impact on the revenue budget for the periods of the loans.

- Whilst the PWLB will remain the main source of borrowing, consideration will also be given to sourcing funding from local authorities, financial institutions and the Municipal Bonds Agency.

- PWLB rates on loans of 25 years duration are expected to be higher than the rates for shorter- and longer-term loans. However, the existing debt maturity profile of the Authority will also be considered when decisions are made regarding the duration of new borrowing, as will the new Liability Benchmark indicator. The Authority will strive to seek a balance between securing the most advantageous rate whilst ensuring that it is not unduly exposed to re-financing risk.

- The whole-life costs of maturity loans can be less than those of equivalent annuity or EIP (equivalent instalments of principal) loans. However, sole reliance on maturity loans can increase the risk of future breaches of the capital financing requirement. It can also lead to future levels of excess borrowing which then have to be invested, resulting in a level of treasury investments above that reasonably required for liquidity. This can increase the Authority's exposure to risk. All these factors will be considered before future borrowing decisions are made.

2.24 Ordinarily the Authority will seek to keep its level of external borrowing in line with its CFR, or to maintain an under-borrowed position where the CFR has not been fully funded by external debt. In an under-borrowed position the Authority uses the cash supporting its reserves and balances to temporarily finance capital expenditure. The use of cash balances in this way is known as "internal borrowing", and this strategy can be prudent if investment returns are lower than borrowing rates. It also eliminates counterparty risk. However, it is recognised that internal borrowing brings a different kind of risk, as there is a chance that balances may need to be replenished at a time when interest rates are higher. In this respect, internal borrowing is effectively variable rate debt. For this reason, the Authority has a local indicator that limits the level of internal borrowing to 20% of the underlying borrowing requirement. Occasionally the Authority may maintain an over-borrowed position where the level of borrowing exceeds its CFR. For example, if interest rates are expected to rise sharply it may be prudent to borrow in advance of future need in order to secure borrowing at a reasonable rate.

2.25 Officers, in conjunction with treasury advisors, will continually monitor both the prevailing interest rates and market forecasts, adopting the following responses to a change in position:

- if it were felt that there was a significant risk of a sharp **fall** in long- and short-term rates then long-term borrowings will be postponed.

- if it were felt that there was a significant risk of a much sharper **rise** in long- and short-term rates than that currently forecast, then the portfolio position will be re-appraised with the likely action that fixed rate funding will be drawn whilst interest rates are still lower than they are projected to be in the next few years.

2.26 The Authority's gross debt position is projected to be £32.9m by the end of 2022/23. This exceeds the estimated CFR, which is £31.7m. This is largely due to a decision to borrow in advance of need in 2021/22 in order take advantage of the prevailing low interest rates at a time when they were projected to increase sharply (which they did). However, the Prudential Code requires that external debt does not exceed the CFR in the previous year plus the estimates of any increase in the CFR at the end of the current and next two financial years. By this measure, the level of projected debt at the end of 2022/23 is reasonable. Despite the capital programme currently being fully funded, the Authority recognises that there will be a requirement to borrow in the medium term in order to fund new capital expenditure. Interest rates are forecast to decrease slowly over the next three years, and the Authority will monitor rate changes closely when determining when the time is right to borrow.

2.27 The Authority 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 considered carefully to ensure value for money can be demonstrated and that the Authority can ensure the security of funds invested. In determining whether borrowing will be undertaken in advance of need the Authority will:

- Ensure that such borrowing is only undertaken to finance the capital programme approved within the current Medium Term Financial Strategy;

- Ensure the ongoing revenue liabilities created, and the implications for the future plans and budgets have been considered;

- Evaluate the economic and market factors that might influence the manner and timing of any decision to borrow;

- Consider the alternative interest rate bases available, the most appropriate periods to fund and repayment profiles to use.

2.28 Where the Authority has made a decision to defer long-term borrowing either in order to benefit from a forecasted reduction in interest rates or to avoid unnecessary carrying costs, it may undertake short-term borrowing to alleviate temporary cash shortages caused by internally borrowing cash balances to support capital expenditure.

2.29 The rescheduling of debt involves the early repayment of existing borrowings and their replacement with new loans. There is still a large difference between premature redemption rates and new borrowing rates, therefore it is unlikely that rescheduling of debt will take place in 2023/24. This will be kept under review should circumstances change. Rescheduling will be considered for the following reasons:

- The generation of cash savings and / or discounted cash flow savings;

- Enhancing the balance of the portfolio by amending the maturity profile.

Any rescheduling of debt will be reported to Members at the earliest meeting following its action.

ANNUAL INVESTMENT STRATEGY

Investment Policy – Management of Risk

2.30 The Authority will have regard to the Department of Levelling Up, Housing and Communities (DLUHC) Guidance on Local Government Investments, the CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes 2021, and the CIPFA Treasury Management Guidance Notes 2021. The Authority's investment priorities are:

(a) the security of capital and
(b) the liquidity of its investments.

The Authority will also aim to achieve the optimum return on its investments commensurate with proper levels of security and liquidity. The risk appetite of this Authority is low in order to give priority to security of its investments. In the current economic climate, it is considered appropriate to keep investments relatively short term to cover cash flow needs. However, where appropriate (from an internal as well as external perspective), the Authority will also consider the value available for longer periods with high credit rated financial institutions, as well as local authorities. The borrowing of monies purely to invest or on-lend and make a return is unlawful and this Authority will not engage in such activity.

2.31 The DLUHC and CIPFA have extended the meaning of “investments” to include both financial and non-financial investments. This Investment Strategy deals solely with financial investments. The Authority does not currently have non-financial investments. Any future non-investment activity (essentially the purchase of income yielding assets) would be covered by the Capital Strategy.

2.32 The guidance from the DLUHC and CIPFA place a high priority on the management of risk. The Authority has adopted a prudent approach to managing risk and defines its risk appetite by the following means:

1. 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 the counterparties are the short term and long-term ratings.

2. **Other information**: ratings are not the sole determinant of the quality of an institution; it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To achieve this consideration the Authority will engage with its advisors to maintain a monitor on market pricing such as “credit default swaps” and overlay that information on top of the credit ratings. Other information sources used will include the financial press, share price and other such information pertaining to the banking sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.

3. The DLUCH’s Guidance on Local Government Investments groups financial investments into one of three categories:

    - **Specified investments** are those with a high level of credit quality and are subject to a maturity limit of one year. They are denominated in sterling and any payments or repayments in respect of the investments are payable only in sterling.
    - **Loans** are made to local enterprises, local charities, wholly owned companies and joint ventures as part of a wider strategic goal. Such loans might not be seen as prudent if adopting a narrow definition of prioritising security or liquidity, but may be acceptable in the wider context of the Authority’s strategic aims.
    - **Non-specified investments** are any financial investments that are not a loan and do not meet the criteria to be treated as a specified investment.

    This Authority will not invest in financial instruments that are categorised as “non-specified”, with the exception of instruments with a maturity of more than one year that would otherwise meet the criteria of a “specified” investment. The Authority’s criteria for specified investments can be found in Appendix E, and the policy regarding loans is detailed in paragraph 2.48.

4. **Lending limits** (amounts and maturity) for each counterparty will be set in accordance with the guidelines detailed in Appendix E.

5. The Authority will set a limit for the amount of its investments which are invested for **longer than 365 days** (see paragraph 2.43).

6. Investments will only be placed with counterparties from countries with a specified minimum **sovereign rating** (see paragraph 2.40).

7. The Authority has engaged **external consultants** (see paragraph 1.10) to provide expert advice on how to optimise an appropriate balance of security, liquidity and yield in the context of the expected level of cash balances and the need through liquidity throughout the year, given the Authority's risk appetite.

8. All investments will be denominated in **sterling.**

9. As a result of the change in accounting standards for 2022/23 under IFRS 9, this authority will consider the implications of investment instruments which could result in an adverse movement in the value of the amount invested and resultant charges at the end of the year to the General Fund. In November 2018, the MHCLG, concluded a consultation for a temporary override to allow English local authorities time to adjust their portfolio of all pooled investments by announcing a statutory override to delay implementation of IFRS 9 for five years ending 31 March 2023. It has not yet been determined whether a further extension to the override will be agreed by the Government. This Authority holds no investment instruments that are affected by this change.

2.33 The Authority will pursue value for money in its treasury management activity and will monitor yield from investment income against appropriate benchmarks for investment performance (see paragraphs 2.49 to 2.52). Regular monitoring of investment performance will be carried out during the year.

Creditworthiness Policy

2.34 The Authority applies the creditworthiness service provided by the Link Group This service employs a sophisticated modelling approach with credit ratings from all three rating agencies - Fitch, Moodys and Standard and Poors forming the core element. It is recognised that ratings should not be the sole determinant of the quality of an institution, and Link's creditworthiness service does not rely solely on the current credit ratings of counterparties but also uses the following as overlays:

- Credit watches and credit outlooks from credit rating agencies;

- Credit Default Swap (CDS) spreads to give early warning of likely changes in credit ratings;

- Sovereign ratings to select counterparties from only the most creditworthy countries;

2.35 The modelling approach combines credit ratings, credit watches, and credit outlooks in a weighted scoring system which is then combined with an overlay of CDS spreads. The end product is a series of colour code bands which indicate the relative creditworthiness of counterparties and enable diversification in investments. These colour codes are used by the Authority to determine both the creditworthiness of institutions and the duration for investments. It is regarded as an essential tool, which the Authority would not be able to replicate using in-house resources.

2.36 The selection of counterparties with a high level of creditworthiness will be achieved by selection of institutions down to a minimum durational band within Link's weekly credit list of potential counterparties. The Authority will therefore use counterparties within the following durational bands:

- Purple band - 24 months
- Blue band - 12 months (only applies to nationalised or semi-nationalised UK banks)
- Orange band – 12 months
- Red band - 6 months
- Green band - 100 days

2.37 The Link Asset Services' creditworthiness service uses a wider array of information other than just primary ratings. Furthermore, by using a risk weighted scoring system, it does not give undue preponderance to just once agency's ratings. Typically, the minimum credit ratings criteria the Authority use will be a Short Term rating (Fitch or equivalent) of F1 and a Long Term rating of A-. There may be occasions when the counterparty ratings from one rating agency are marginally lower than these ratings but may still be used. In these instances, consideration will be given to the whole range of ratings available, or other topical information, to support their use.

2.38 The Authority is alerted to changes to ratings of all three agencies through its use of the Link Assets Services' creditworthiness service. If a downgrade results in the counterparty or investment scheme no longer meeting the Authority's minimum criteria, its further use as a new investment will be withdrawn immediately and consideration will be given to withdrawing any amounts held in notice accounts. In addition to the use of Credit Ratings the Authority will be advised of information in movements in Credit Default Swap against the iTraxx benchmark and other market data on a weekly basis. Extreme market movements may result in downgrade of an institution or removal from the Authority's lending list.

2.39 Sole reliance will not be placed on the use of this external service. In addition, this Authority will also use market data and market information, as well as information on any external support for banks to help support its decision-making process.

Country Limits

2.40 The Authority has previously determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of AA from Fitch Ratings (or equivalent from other agencies if Fitch does not provide). The list of countries that qualify using this credit criteria as at the date of this report are shown in Appendix F. This list will be added to or deducted from by Officers should ratings change in accordance with this policy. An exception to this policy is made for the UK, which is currently rated as AA-. The Authority continues to use counterparties from the UK, subject to the creditworthiness criteria outlined in paragraph 2.36.

Environmental, Social and Governance

2.41 One of the requirements of the revised Treasury Management Code of Practice (see paragraph 1.6) is that the Authority includes a policy relating to Environmental, Social and Governance (ESG) considerations. Fire Authority is requested to approve this policy which is set out in Appendix G.

Investment Strategy

2.42 Investments will be made with reference to the core balance and cash flow requirements of the Authority, and the outlook for short term interest rates (i.e. rates for investments up to 12 months). Greater returns are usually obtainable by investing for longer periods. While most cash balances are required in order to manage fluctuations in cash flow, it may sometimes be possible to identify cash sums that could be invested for longer periods. Should this be the case, the value to be obtained from longer term investments will be carefully assessed:

- If it is thought that the Bank Rate is likely to rise significantly within the time horizon being considered, then consideration will be given to keeping most investments as being short term or at variable rates.
- Conversely, if it is thought that the Bank Rate is likely to fall within that time period, consideration will be given to locking in the higher rates currently obtainable, for longer periods.

2.43 Bank Rate is forecast to peak at around 4.50% during 2023 and then steadily reduce to 2.50% by the latter half of 2025. In the current financial climate, it’s appropriate to maintain an agile investment strategy, so no term deposit investments will be made for a period greater than one year without the prior approval of the Head of Finance and Treasurer to the Authority. The Authority will avoid locking into longer term deals unless exceptionally attractive rates are available which make longer terms deals worthwhile. The proposed upper limit for principal sums invested for periods longer than 365 days is £2m (see the Prudential and Treasury Indicators in Appendix D).

2.44 In accordance with its low risk appetite, the Authority may undertake the following types of “specified” investments:

- Deposits with the Debt Management Office (Government);
- Term deposits with Banks and Building Societies;
- Call deposits with Banks and Building Societies;
- Term Deposits with uncapped English and Welsh local authority bodies;
- Triple-A rated Money Market Funds (CNAV and LVNAV);
- UK Treasury Bills;
- Certificates of Deposit.

2.45 The risks associated with investing will be reduced if investments are spread e.g. over counterparties or over countries. The Authority will therefore aim to limit its investment with any single counterparty to £2m where possible. However, where a lack of suitable counterparties renders this £2m limit unworkable a maximum of £4m per counterparty is permitted. Despite this Officers will, wherever possible, avoid the concentration of investments with one counterparty or group.

2.46 The Authority currently accesses counterparties directly or via a broker, and officers also have the option to access counterparties via Link’s Agency Treasury Service. The Agency Treasury Service pools investments from Link’s clients and places them with counterparties.

2.47 A summary of the criteria for specified investments is shown in Appendix E. The same criteria shall apply to non-specified investments with the exception of the maximum maturity period, which may exceed 12 months.

2.48 In addition to specified investments, the Authority may choose to make loans to local enterprises, local charities, wholly owned companies and joint ventures if doing so would contribute to its wider strategic goals. Before making such a loan the Authority would seek approval from the Finance and Resources Committee, having demonstrated the following:

- The total financial exposure to the loan is proportionate;
- An allowed “expected credit loss” model for loans and receivables as set out in International Financial Reporting Standard 9 can be applied to measure the credit risk of the loan portfolio; and
- Appropriate credit control arrangements are in place to recover overdue payments.

Investment Risk Benchmarking

2.49 The Authority has adopted benchmarks to assess the security, liquidity and yield of its investments. These benchmarks are simple guides to maximum risk, so may be breached from time to time depending on movements in interest rates and counterparty criteria. The purpose of the benchmark is that officers will monitor the current and trend position and amend the operational strategy to manage risk as conditions change. Any breach will be reported with supporting reasons in the Treasury Management Mid-year or Annual Report.

2.50 **Security -** security is currently evidenced by the application of minimum credit quality criteria to investment counterparties, primarily through the use of the creditworthiness service provided by Link Asset Services. Typically, the minimum credit criteria used by the Authority equates to a long term rating of A- (Fitch or equivalent). This means that the average expectation of default is around 0.08% of the total investment (e.g. for a £1m investment the average loss would be £800). This is only an average, and any specific counterparty loss is likely to be higher, however these figures can be used as a benchmark for the security of the investment portfolio.

It is suggested that the Authority adopt a maximum security risk benchmark of **0.08%** historic risk of default when compared to the whole portfolio.

2.51 **Liquidity -** this is defined as "having adequate, though not excessive cash resources, borrowing arrangements, overdrafts and standby facilities to enable it at all times to have the level of funds available to it which are necessary for the achievement of its business/service objectives" (CIPFA Treasury Management Code of Practice). In respect of this area the Authority seeks to maintain:

- A bank overdraft of £500k
- Adequate liquid short term deposits available at a week's notice

The availability of liquidity and the term risk in the portfolio can be benchmarked by the monitoring of the Weighted Average Life (WAL) of the portfolio. A shorter WAL would generally embody less risk.

The WAL benchmark is **approximately 3 months**, with a recommended maximum limit of **0.40 years.**

2.52 **Yield -** the local measure of yield benchmark is:

Investments – internal returns **above the 3-month SONIA compounded rate**

MINIMUM REVENUE PROVISION POLICY 2023/24

2.53 The Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2008 came into force on 31 March 2008. These regulations were an amendment to the 2003 regulations and introduced several changes to the capital finance regime for local authorities (including fire authorities) in England. The most significant of these were provisions dealing with the calculation of Minimum Revenue Provision (MRP), which is the amount an authority charges to its revenue account in respect of the financing of capital expenditure.

2.54 Regulation 27 of the 2003 Regulations requires a local authority to calculate in each financial year an amount of MRP that it considers to be prudent. An underpinning principle of the local authority financial system is that all capital expenditure has to be financed either from capital receipts, capital grants (or other contributions) or eventually from revenue income. The broad aim of prudent provision is to require local authorities to put aside revenue over time to cover their CFR. In doing so, local authorities "should align the period over which they charge MRP to one that is commensurate with the period over which their capital expenditure provides benefits". This guidance translates into the asset life method. Authorities are permitted to continue charging MRP calculated using the old method for borrowing and credit arrangements which funded capital expenditure incurred before 1 April 2007. This method calculates a charge of 4% of the capital financing requirement each year to revenue.

2.55 The following policy on MRP is therefore recommended to members and budgetary provision for MRP has been made on this basis:

- For all borrowing and credit arrangements to fund capital expenditure incurred before or during 2006/07, the minimum revenue provision applied in 2023/24 will continue to be calculated on the basis of the 4% CFR (capital financing requirement) method. This method will continue to be used in future years for capital expenditure incurred during or before 2006/07.

- For borrowing and credit arrangements (excluding leases) to fund capital expenditure incurred from 2007/08 onwards, the minimum revenue provision applied in 2023/24 will be calculated on the basis of the Asset Life method.

- The minimum revenue provision for capital expenditure funded by leasing will match the payment of principal over the lease term.

2.56 The regulations also allow for Voluntary Revenue Provision (VRP) charges to be made. A VRP charge would be in addition to the MRP charge and would have the effect of reducing MRP charges in future years, resulting in revenue budget savings. If the situation arises in the year whereby Officers feel that a VRP charge would be advantageous (e.g. if there are revenue budget underspends), then a recommendation will be made to Finance and Resources Committee to approve a VRP charge during the year.

2.57 A change introduced by the revised MRP Guidance was the allowance that any charges made over the statutory minimum revenue provision (MRP), voluntary revenue provision or overpayments, can, if needed, be reclaimed in later years if deemed necessary or prudent. In order for these sums to be reclaimed for use in the budget, this policy must disclose the cumulative overpayment made each year. Up until the 31 March 22 the total VRP overpayments were £1.312m.

TRAINING OF OFFICERS AND MEMBERS

2.58 Under the Code, good practice is defined as ensuring that all staff involved in treasury management are appropriately trained and experienced to undertake their duties. Employees within the Finance Department who carry out treasury management activities are suitably trained and experienced and routinely attend at least one treasury management update event each year to ensure that their knowledge keeps pace with changes. A knowledge and skills register is being developed which will help to identify any further training needs and enable to employees' training activities to be monitored more effectively.

2.59 It is also suggested that those tasked with treasury management scrutiny responsibilities have access to suitable training. A training session will be planned during 2023/24.

3. FINANCIAL IMPLICATIONS

The financial implications are set out in full within the body of the report.

4. HUMAN RESOURCES AND LEARNING AND DEVELOPMENT IMPLICATIONS

There are no human resources or learning and development implications arising from this report.

5. EQUALITIES IMPLICATIONS

There are no equalities implications arising from this report.

6. CRIME AND DISORDER IMPLICATIONS

There are no crime and disorder implications arising from this report.

7. LEGAL IMPLICATIONS

There are no legal implications arising from this report, other than the requirement to act within the Authority's powers when undertaking treasury management borrowings and investments.

8. RISK MANAGEMENT IMPLICATIONS

The investment of local authority funds cannot be achieved without some element of risk. Careful choice of borrowers using creditworthiness indices will minimise this risk. This prudent approach will undoubtedly result in some interest rate loss but the principles of security and liquidity are paramount.

9. COLLABORATION IMPLICATIONS

There are no collaboration implications arising from this report.

10. RECOMMENDATIONS

It is recommended that Members approve:

10.1 The Treasury Management Strategy 2023/24 as set out in this report.

10.2 The Policy on Environmental, Social and Governance (ESG) considerations as set out in Appendix F.

10.2 The Minimum Revenue Provision policy 2023/24 as set out in paragraphs 2.53 to 2.57.

11. BACKGROUND PAPERS FOR INSPECTION (OTHER THAN PUBLISHED DOCUMENTS)

None.

Becky Smeathers
TREASURER TO THE FIRE AUTHORITY

APPENDIX A

TREASURY MANAGEMENT POLICY STATEMENT

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

2. The Authority regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the organisation.

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

APPENDIX B

ECONOMIC SUMMARY

Prepared by Link Asset Services December 2022

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, it is no surprise that UK interest rates have been volatile right across the curve, from Bank Rate through to 50-year gilt yields, for all of 2022.

Market commentators' misplaced optimism around inflation has been the root cause of the rout in the bond markets with, for example, UK, EZ and US 10-year yields all rising by over 200bps since the turn of the year. The table below provides a snapshot of the conundrum facing central banks: inflation is elevated but labour markets are extra-ordinarily tight, making it an issue of fine judgment as to how far monetary policy needs to tighten.

	UK	Eurozone	US
Bank Rate	3.5%	2.0%	4.25%-4.50%
GDP	-0.2%q/q Q3 (2.4%y/y)	+0.2%q/q Q3 (2.1%y/y)	2.6% Q3 Annualised
Inflation	10.7%y/y (Nov)	10.1%y/y (Nov)	7.1%y/y (Nov)
Unemployment Rate	3.7% (Oct)	6.5% (Oct)	3.7% (Nov)

Q2 of 2022 saw UK GDP revised upwards to +0.2% q/q, but this was quickly reversed in the third quarter, albeit some of the fall in GDP can be placed at the foot of the extra Bank Holiday in the wake of the Queen's passing. Nevertheless, CPI inflation has picked up to what should be a peak reading of 11.1% in October, although with further increases in the gas and electricity price caps pencilled in for April 2023, and the cap potentially rising from an average of £2,500 to £3,000 per household, there is still a possibility that inflation will spike higher again before dropping back slowly through 2023.

The UK unemployment rate fell to a 48-year low of 3.6%, and this despite a net migration increase of c500k. The fact is that with many economic participants registered as long-term sick, the UK labour force actually shrunk by c500k in the year to June. Without an increase in the labour force participation rate, it is hard to see how the UK economy will be able to grow its way to prosperity, and with average wage increases running at over 6% the MPC will be concerned that wage inflation will prove just as sticky as major supply-side shocks to food and energy that have endured since Russia's invasion of Ukraine on 22nd February 2022.

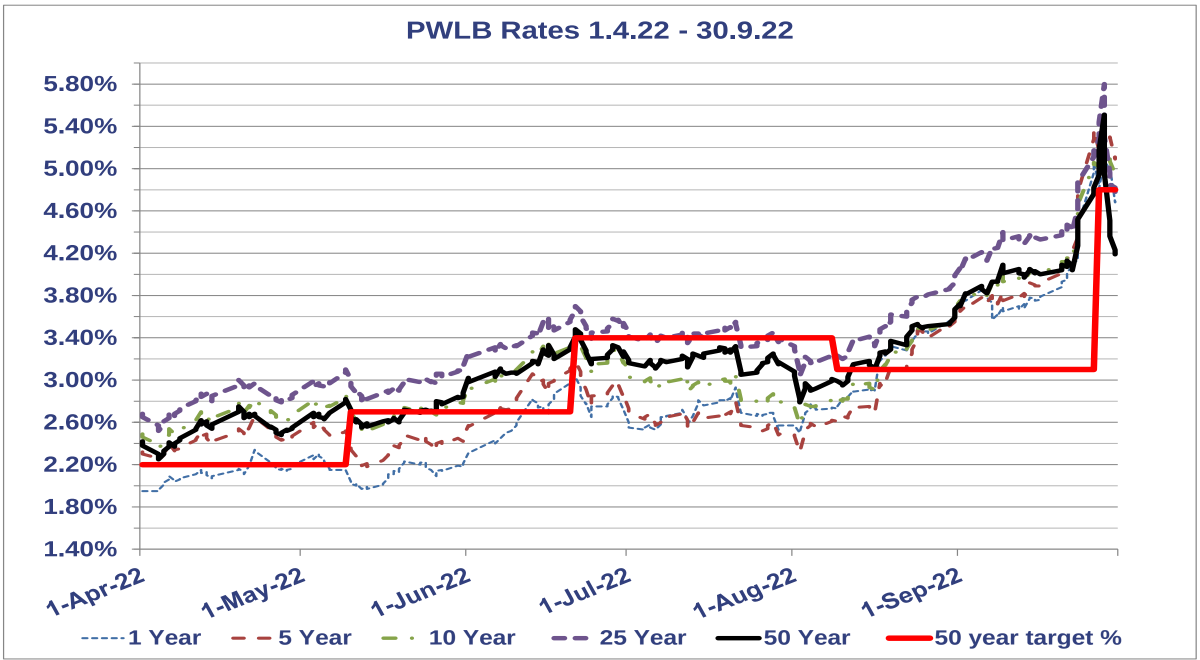
Throughout Q3 Bank Rate increased, finishing the quarter at 2.25% (an increase of 1%). Q4 has seen rates rise to 3.5% in December and the market expects Bank Rate to hit 4.5% by May 2023.

Following a Conservative Party leadership contest, Liz Truss became Prime Minister for a tumultuous seven weeks that ran through September and October. Put simply, the markets did not like the unfunded tax-cutting and heavy spending policies put forward by her Chancellor, Kwasi Kwarteng, and their reign lasted barely seven weeks before being replaced by Prime Minister Rishi Sunak and Chancellor Jeremy Hunt. Their Autumn Statement of 17 November gave rise to a net £55bn fiscal tightening, although much of the "heavy lifting" has been left for the next Parliament to deliver. However, the markets liked what they heard, and UK gilt yields have almost completely reversed the increases seen under the previous tenants of No10/11 Downing Street.

Globally, though, all the major economies are expected to struggle in the near term. The fall below 50 in the composite Purchasing Manager Indices for the UK, US, EZ and China all point to at least one, if not more, quarters of GDP contraction. In November, the MPC projected eight quarters of negative growth for the UK lasting throughout 2023 and 2024, but with Bank Rate set to peak at lower levels than previously priced in by the markets and the fiscal tightening deferred to some extent, it is not clear that things will be as bad as first anticipated by the Bank.

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. Notwithstanding the £'s better run of late, 2023 is likely to see a housing correction of some magnitude as fixed-rate mortgages have moved above 5% and affordability has been squeezed despite proposed Stamp Duty cuts remaining in place.

In the table below, the rise in gilt yields, and therein PWLB rates, through the first half of 2022/23 is clear to see.



However, the peak in rates on 28 September as illustrated in the table covering April to September 2022 below, has been followed by the whole curve shifting lower. PWLB rates at the front end of the curve are generally over 1% lower now whilst the 50 years is over 1.75% lower.

	1 Year	5 Year	10 Year	25 Year	50 Year
Low	1.95%	2.18%	2.36%	2.52%	2.25%
Date	01/04/2022	13/05/2022	04/04/2022	04/04/2022	04/04/2022
High	5.11%	5.44%	5.35%	5.80%	5.51%
Date	28/09/2022	28/09/2022	28/09/2022	28/09/2022	28/09/2022
Average	2.81%	2.92%	3.13%	3.44%	3.17%
Spread	3.16%	3.26%	2.99%	3.28%	3.26%

After a shaky start to the year, the S&P 500 and FTSE 100 have climbed in recent weeks, albeit the former is still 17% down and the FTSE 2% up. The German DAX is 9% down for the year.

CENTRAL BANK CONCERNS – DECEMBER 2022

In December, the Fed decided to push up US rates by 0.5% to a range of 4.25% to 4.5%, whilst the MPC followed by raising Bank Rate from 3% to 3.5%, in line with market expectations. EZ rates have also increased to 2% with further tightening in the pipeline.

Having said that, the sentiment expressed in the press conferences in the US and the UK were very different. In the US, Fed Chair, Jerome Powell, stated that rates will be elevated and stay higher for longer than markets had expected. Governor Bailey, here in the UK, said the opposite and explained that the two economies are positioned very differently so you should not, therefore, expect the same policy or messaging.

Regarding UK market expectations, although they now expect Bank Rate to peak within a lower range of 4.5% - 4.75%, caution is advised as the Bank of England Quarterly Monetary Policy Reports have carried a dovish message over the course of the last year, only for the Bank to have to play catch-up as the inflationary data has proven stronger than expected.

In addition, the Bank's central message that GDP will fall for eight quarters starting with Q3 2022 may prove to be a little pessimistic. Will the £160bn excess savings accumulated by households through the Covid lockdowns provide a spending buffer for the economy – at least to a degree? Ultimately, however, it will not only be inflation data but also employment data that will mostly impact the decision-making process, although any softening in the interest rate outlook in the US may also have an effect (just as, conversely, greater tightening may also).

INTEREST RATE FORECASTS 2022-2025 **APPENDIX C**

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

PWLB forecasts are based on PWLB certainty rates.

APPENDIX D

PRUDENTIAL AND TREASURY INDICATORS FOR 2023/24

Maximum ratio of Financing Costs to Net Revenue Stream	8.0%
Estimate of Ratio of Financing Costs to Net Revenue Stream	5.0%
Estimate of Total Capital Expenditure to be Incurred	£3,995,000
Estimate of Capital Financing Requirement	£30,646,000
Operational Boundary	£36,901,000
Authorised Limit	£41,591,000
Upper limit for fixed rate interest exposures	100%
Upper limit for variable rate interest exposures	30%
Loan Maturity:	Limits:
Under 12 months	Upper 20% Lower 0%
12 months to 5 years	Upper 30% Lower 0%
5 years to 10 years	Upper 75% Lower 0%
Over 10 years	Upper 100% Lower 0%
Over 20 years	Upper 100% Lower 30%
Upper Limit for Principal Sums Invested for Periods Longer than 365 Days	£2,000,000

LOCAL INDICATORS FOR 2023/24

Upper limit for internal borrowing as a % of the Capital Financing Requirement	20%
Lower limit for proportion of net debt to gross debt	50%
Upper limit for proportion of net debt to gross debt	85%
Investment security benchmark: maximum historic default risk of investment portfolio	0.08%
Investment liquidity benchmark: maximum weighted average life of investment portfolio	0.40 years
Investment yield benchmark	Internal returns to be above 3 month compounded SONIA rate

APPENDIX E

SPECIFIED INVESTMENTS: CREDIT AND COUNTERPARTY RISK

Investment category	Minimum credit criteria / colour band	Sovereign credit rating	Category as a % of total investments	Total limit per institution* / fund	Max. maturity period
Term deposits with banks and building societies	Purple (24 months) Blue (1 year – only applies to nationalised or semi nationalised UK banks) Orange (1 year) Red (6 months) Green (100 days)	Fitch AA or equivalent	100%	£4m per institution	As per durational banding, subject to limit of 12 months
Notice accounts with banks and building societies	Purple (24 months) Blue (1 year – only applies to nationalised or semi nationalised UK banks) Orange (1 year) Red (6 months) Green (100 days)	Fitch AA or equivalent	100%	£4m per institution	Minimum notice period to be as per durational banding (subject to limit of 12 months). The total period of investment may be greater than 12 months
Local authorities	N/A	N/A	100%	£4m per institution	12 months
Money Market Funds CNAV (government debt)	AAA	N/A	50%	£4m per fund	Liquid
Money Market Funds LVNAV	AAA	N/A	50%	£4m per fund	Liquid
UK Government Treasury Bills	UK sovereign rating	N/A	100%	N/A	12 months
Certificates of Deposit with banks and building societies	Purple (24 months) Blue (1 year – only applies to nationalised or semi nationalised UK banks) Orange (1 year) Red (6 months) Green (100 days)	Fitch AA or equivalent	50%	£4m per institution	As per durational banding, subject to limit of 12 months
Debt Management Account Deposit Facility (DMADF) – UK Government	N/A	N/A	100%	N/A	6 months

** The institution limit applies across all categories, i.e. it is the total amount that may be invested in the institution at any point in time (excluding any amounts invested in that institution by money market funds).*

APPENDIX F

APPROVED COUNTRIES FOR INVESTMENTS

AAA	AA+	AA
Australia	Canada	Abu Dhabi (UAE)
Denmark	Finland	France
Germany	USA	
Netherlands		
Norway		
Singapore		
Sweden		
Switzerland		

This list is correct as at 19/12/2022

APPENDIX G

Policy on Environmental, Social and Governance (ESG) Considerations

1.1 Current investment guidance, both statutory and from CIPFA, makes it clear that all investment strategies must adopt Security, Liquidity and Yield (SLY) principles and that ethical principles must play a subordinate role to these key principles. Priority will therefore be given to security, liquidity and yield when investment decisions are made. ESG principles will only be accommodated once SLY requirements have been met.

1.2 ESG factors that are considered by Credit Rating Agencies, such as Fitch, Moody's and Standard & Poor's when assigning credit ratings to counterparties are detailed below. The credit ratings provided by these agencies are also used as the basis for selecting suitable counterparties.

- ***Environmental:*** *Emissions and air quality, energy and waste management, waste and hazardous material, exposure to environmental impact.*

- ***Social:*** *Human rights, community relations, customer welfare, labour relations, employee wellbeing, exposure to social impacts.*

- ***Governance:*** *Management structure, governance structure, group structure, financial transparency.*

1.3 Currently, the assessment and implementation of ESG considerations are better developed in equity and bond markets than for short-term cash deposits, primarily due to the wider scope of potential investment opportunities. Furthermore, there is a diversity of market approaches to ESG classification, analysis and integration. This means that a consistent and developed approach to ESG for public service organisations, focussed on more typical Treasury-type investments, is currently difficult to achieve.

1.4 The Authority is supportive of the Principles for Responsible Investment (www.unpri.org) and will seek to bring ESG factors into the decision making process for investments where possible. The Authority is also appreciative of the Statement on ESG in Credit Risk and Ratings which commits signatories to incorporating ESG into credit ratings and analysis in a systemic and transparent way. The Authority uses ratings from Fitch, Moody's and Standard & Poor's to support its assessment of suitable counterparties. Each of these rating agencies is a signatory to the ESG in credit risk and ratings statement, which is as follows:

> *"We, the undersigned, recognise that environmental, social and governance (ESG) factors can affect borrowers' cash flows and the likelihood that they will default on their debt obligations. ESG factors are therefore important elements in assessing the creditworthiness of borrowers. For corporates, concerns such as stranded assets linked to climate change, labour relations challenges or lack of transparency around accounting practices can cause unexpected losses, expenditure, inefficiencies, litigation, regulatory pressure and reputational impacts.*

At a sovereign level, risks related to, inter alia, natural resource management, public health standards and corruption can all affect tax revenues, trade balance and foreign investment. The same is true for local governments and special purpose vehicles issuing project bonds. Such events can result in bond price volatility and increase the risk of defaults.
In order to more fully address major market and idiosyncratic risk in debt capital markets, underwriters, credit rating agencies and investors should consider the potential financial materiality of ESG factors in a strategic and systematic way. Transparency on which ESG factors are considered, how these are integrated, and the extent to which they are deemed material in credit assessments will enable better alignment of key stakeholders.
In doing this the stakeholders should recognise that credit ratings reflect exclusively an assessment of an issuer's creditworthiness. Credit rating agencies must be allowed to maintain full independence in determining which criteria may be material to their ratings. While issuer ESG analysis may be considered an important part of a credit rating, the two assessments should not be confused or seen as interchangeable.

With this in mind, we share a common vision ***to enhance systematic and transparent consideration of ESG factors in the assessment of creditworthiness****."*

1.5 For short term investments with counterparties, this Authority utilises the ratings provided by Fitch, Moody's and Standard & Poor's to assess creditworthiness, which do include analysis of ESG factors when assigning ratings. The Authority will continue to evaluate additional ESG-related metrics and assessment processes that it could incorporate into its investment process and will update accordingly.