APPENDIX C: JOINT TREASURY MANAGEMENT STRATEGY 2022/23

1. Introduction

1.1 The Joint Treasury Management strategy contains the following:

- Borrowing Strategy (section 4)
- Annual Investment Strategy (section 5)
- Treasury Management Indicators (Appendix D)
- Economic and Interest Rate Forecast (Appendix E)
- Existing Investment and Debt Portfolio (Appendix F)
- Treasury Management Policy Statement (Appendix G)

1.2 Treasury management is the management of the Councils' cash flows, borrowing and investments, and the associated risks. Babergh and Mid Suffolk invest surplus funds and both Councils borrow to fund capital investment and manage cash flows. Both Councils are therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates.

1.3 The successful identification, monitoring and control of financial risk are therefore central to the Councils' prudent financial management.

1.4 The Councils will continue to:

- Make use of call accounts, if necessary
- Use the strongest/lowest risk non-credit rated building societies
- Use covered bonds (secured against assets) for longer term investments
- Consider longer term investments in property or other funds

1.5 The Local Government Act 2003 requires the Councils to have regard to CIPFA's Prudential Code for Capital Finance in Local Authorities 2017 (the Prudential Code) when determining how much money they can afford to borrow.

1.6 Treasury risk management at both Councils is conducted within the framework of the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2017 Edition (the TM Code) which requires the Councils to approve a treasury management strategy before the start of each financial year. This report fulfils the Councils legal obligation under the Local Government Act 2003 to have regard to the TM Code.

1.7 The DLUHC Investment Guidance 2018, in paragraph 21, requires local authorities to prioritise Security, Liquidity and Yield in that order of importance.

1.8 The Joint Treasury Management Strategy for 2022/23 continues to focus primarily on the effective management and control of risk and striking a balance between the security, liquidity and yield of those investments. The Councils' objective when investing money is to strike an appropriate balance between risk and return.

1.9 Details of investments held for service purposes or for commercial profit are included in the Joint Investment Strategy shown in Appendix B.

2. External Context

2.1 A detailed economic and interest rate forecast provided by Arlingclose is attached at Appendix E.

3. Local Context

Interest rates on Investments and Borrowing

3.1 For the purpose of setting the budget, it has been assumed that new short-term investments will be made at an average rate of between 0.01% and 0.08%, and that new long-term loans will be borrowed at an average rate between 1.8% and 2.8%.

Capital Financing Requirement

3.2 The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. The Councils' current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing.

3.3 As at 30 November 2021, Babergh held £118.67m of borrowing and £21.63m of investments, Mid Suffolk held £132.88m of borrowing and £19.75m of investments. This is set out in further detail at Appendix F. Forecast changes in these sums are shown in the following balance sheet analysis:

Table 1: Capital Financing Requirement Summary and forecast

Cumulative Capital Financing Requirement						
Babergh	2020/21 Actual £m	2021/22 Forecast Outturn £m	2022/23 Budget £m	2023/24 Forecast £m	2024/25 Forecast £m	2025/26 Forecast £m
Total CFR	160.21	162.03	182.96	184.81	182.81	179.53
Less: Other Debt Liabilities *	0.00	0.00	(0.30)	(0.22)	(0.14)	(0.05)
Loans CFR	**160.21**	**162.03**	**182.65**	**184.59**	**182.68**	**179.48**
Less: External Borrowing**	(127.09)	(118.40)	(117.84)	(117.28)	(110.71)	(104.12)
Internal (Over) Borrowing (Cumulative)	**33.12**	**43.63**	**64.81**	**67.31**	**71.97**	**75.36**
Less: Balances & Reserves-General Fund	(24.23)	(18.33)	(17.74)	(17.55)	(17.45)	(17.37)
Less: Balances & Reserves-HRA	(19.59)	(9.10)	(3.57)	(5.63)	(4.73)	(5.70)
Less: Working Capital Surplus	0.13	0.13	0.13	0.13	0.13	0.13
New Net (Investment) / Borrowing Requirement	**(10.57)**	**16.33**	**43.64**	**44.26**	**49.92**	**52.42**

Cumulative Capital Financing Requirement						
Mid Suffolk	2020/21 Actual £m	2021/22 Forecast Outturn £m	2022/23 Budget £m	2023/24 Forecast £m	2024/25 Forecast £m	2025/26 Forecast £m
Total CFR	183.77	194.34	245.19	245.70	227.26	209.57
Less: Other Debt Liabilities *	0.00	0.00	(0.34)	(0.24)	(0.14)	(0.05)
Loans CFR	**183.77**	**194.34**	**244.85**	**245.46**	**227.12**	**209.52**
Less: External Borrowing**	(142.57)	(118.34)	(98.73)	(90.10)	(88.95)	(87.79)
Internal (Over) Borrowing (Cumulative)	**41.20**	**76.01**	**146.13**	**155.36**	**138.17**	**121.73**
Less: Balances & Reserves-General Fund	(45.66)	(43.73)	(38.17)	(37.77)	(37.46)	(37.16)
Less: Balances & Reserves-HRA	(8.84)	(3.01)	(2.92)	(2.70)	(3.02)	(3.77)
Add: Working Capital Deficit	(1.81)	(1.81)	(1.81)	(1.81)	(1.81)	(1.81)
New Net (Investment) / Borrowing Requirement	**(15.11)**	**27.46**	**103.22**	**113.07**	**95.88**	**78.99**

* leases form part of the Councils' total debt
** shows only loans to which the Councils are currently committed and excludes optional refinancing.

3.4 The Councils have CFRs which increase in the short term and then decrease by the end of the medium term. This is due to the requirements of the capital programme, and investments and will therefore need to borrow up to £52.4m for Babergh and £113m for Mid Suffolk over the forecast period.

3.5 CIPFA's Prudential Code for Capital Finance in Local Authorities recommends that the Councils' total debt should be lower than their highest forecast CFR over the next three years. Table 1 above shows that the Councils expect to comply with this recommendation over the forecast period.

Liability benchmark:

3.6 A liability benchmark has been calculated showing the lowest risk level of borrowing. This assumes the same forecasts as Table 1 above, but that cash and investment balances are kept to a minimum level of Treasury Investments for each Council over the medium-term (the lowest being £13m) to maintain sufficient liquidity but minimise credit risk.

3.7 A comparison of the Councils' actual borrowing against this alternative strategy was shown in Table 7 in Appendix A, paragraph 4.10. This table shows that when the Councils' expected outstanding debt is below the Liability Benchmark (lowest risk level) for the forecast period, it indicates a need to borrow.

Table 2: Liability Benchmark

Liability Benchmark						
Babergh	**2020/21 Actual £m**	**2021/22 Forecast Outturn £m**	**2022/23 Budget £m**	**2023/24 Forecast £m**	**2024/25 Forecast £m**	**2025/26 Forecast £m**
CFR	160.21	162.03	182.96	184.81	182.81	179.53
Less: Usable Reserves	(43.82)	(27.43)	(21.31)	(23.18)	(22.18)	(23.07)
Less: Working Capital Surplus	0.13	0.13	0.13	0.13	0.13	0.13
Plus: Minimum Investments	13.01	13.09	13.06	13.05	13.03	13.00
Liability Benchmark	**129.53**	**147.82**	**174.84**	**174.81**	**173.80**	**169.59**

Liability Benchmark						
Mid Suffolk District Council	**2020/21 Actual £m**	**2021/22 Forecast Outturn £m**	**2022/23 Budget £m**	**2023/24 Forecast £m**	**2024/25 Forecast £m**	**2025/26 Forecast £m**
CFR	183.77	194.34	245.19	245.70	227.26	209.57
Less: Usable Reserves	(54.49)	(46.74)	(41.10)	(40.47)	(40.48)	(40.93)
Add: Working Capital Deficit	(1.81)	(1.81)	(1.81)	(1.81)	(1.81)	(1.81)
Plus: Minimum Investments	14.68	13.09	13.06	13.05	13.03	13.00
Liability Benchmark	**142.15**	**158.88**	**215.34**	**216.46**	**198.00**	**179.83**

4. Borrowing Strategy

Overview

4.1 As at 30 November 2021 Babergh held loans of £118.67m and Mid Suffolk £132.88m. These have increased by £11.66m for Babergh and £9.62m for Mid Suffolk on the previous year, due to funding previous years' capital programmes.

4.2 The balance sheet forecast for borrowing in Table 1 above shows that Babergh would be able to borrow up to £43.64m and Mid Suffolk could borrow up to £103.22m in 2022/23. The Councils may borrow to pre-fund future years' requirements, providing this does not exceed the authorised limit for borrowing of £198m for Babergh and £261m for Mid Suffolk, as shown in Appendix A Table 8.

Objectives

4.3 The Councils' chief objective when borrowing money is to strike an appropriately low risk balance between securing low interest costs and achieving certainty of those costs over the period for which funds are required. A secondary objective is the flexibility to renegotiate loans should the Councils' long-term plans change.

Strategy

4.4 Given the significant cuts to public expenditure and in particular to local government funding, the Councils' borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolios. With short-term interest rates currently much lower than long-term rates, it is likely to be more cost effective in the short-term to either use internal resources, or to borrow short-term loans instead. This position will be monitored and evaluated on an ongoing basis to ensure both Councils achieve value for money.

4.5 By doing so, the Councils are able to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk. The benefits of internal and short-term borrowing will be monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing rates are forecast to rise modestly. Arlingclose (the Councils' treasury advisers) will assist the Councils with this 'cost of carry' and breakeven analysis.

4.6 Its output may determine whether the Councils borrow additional sums at long-term fixed rates in 2022/23 with a view to keeping future interest costs low, even if this causes additional cost in the short-term.

4.7 The Councils have previously raised the majority of their long-term borrowing from the PWLB but will consider borrowing any long-term loans from other sources including banks, pension funds and local authorities, and will investigate the possibility of issuing bonds and similar instruments, in order to lower interest costs and reduce over-reliance on one source of funding in line with the Treasury Management Code.

4.8 PWLB loans are no longer available to local authorities planning to buy investment assets primarily for yield; the Councils intend to avoid this activity in 2022/23 and beyond in order to retain its access to PWLB loans.

4.9 Alternatively, the Councils may arrange forward starting loans during 2022/23, where the interest rate is fixed in advance, but the cash is received in later years. This would enable certainty of cost to be achieved without suffering a cost of carry in the intervening period.

4.10 In addition, the Councils may borrow more short-term loans to cover unplanned cash flow shortages.

Sources of borrowing

4.11 The approved sources of long-term and short-term borrowing are:

- HM Treasury's PWLB lending facility (formerly Public Works Loan Board)
- any institution approved for investments (see below)
- any other bank or building society authorised to operate in the UK
- any other UK public sector body
- UK public and private sector pension funds (except Suffolk County Council Pension Fund)
- capital market bond investors
- UK Municipal Bonds Agency plc and other special purpose companies created to enable local authority bond issues

Municipal Bonds Agency

4.12 UK Municipal Bonds Agency plc was established in 2014 by the Local Government Association as an alternative to the PWLB. It issues bonds on the capital markets and lends the proceeds to local authorities. This is a more complicated source of finance than the PWLB for two reasons:

- borrowing authorities will be required to provide bond investors with a guarantee to refund their investment in the event that the agency is unable to for any reason, and

- there will be a lead time of several months between committing to borrow and knowing the interest rate payable. Any decision to borrow from the Agency will therefore be the subject of a separate report to Full Council

LOBOs

4.13 Mid Suffolk holds £4m of LOBO (Lender's Option Borrower's Option) loans where the lender has the option to propose an increase in the interest rate at set dates, following which the Council has the option to either accept the new rate or to repay the loan at no additional cost. All of these loans have options during 2022/23, and although the Council understands that lenders are unlikely to exercise their options in the current low interest rate environment, there remains an element of refinancing risk. The Council will take the option to repay LOBO loans at no cost if it has the opportunity to do so. Total borrowing via LOBO loans will be limited to £4m.

Short-term and variable rate loans

4.14 These loans leave the Councils exposed to the risk of short-term interest rate rises and are therefore subject to the interest rate exposure limits in the treasury management indicators below.

Other sources of debt finance

4.15 In addition, capital finance may be raised by the following methods that are not borrowing, but may be classed as other debt liabilities:

- leasing
- hire purchase
- Private Finance Initiative
- sale and leaseback

Local Application

4.16 The Councils have previously raised the majority of their long-term borrowing from the PWLB, but continues to investigate other sources of finance, such as local authority loans and bank loans, that may be available at more favourable rates.

4.17 Consideration will be given to all forms of borrowing/financing in relation to any future capital investment plans. This is most likely to be via the Public Works Loan Board (PWLB) but consideration will also be given to borrowing from other sources such as other local authorities, commercial banks, the money markets, capital markets (stock issues, commercial paper and bills) and leasing. The Councils will receive the “certainty rate” discount of 0.2% on PWLB loans. An “infrastructure rate” discount of 0.4% is also available for lending to support nominated infrastructure projects.

4.18 In conjunction with advice from Arlingclose, both Councils will keep these sources of finance under review.

4.19 Officers will take advice on the optimum time to undertake additional borrowing and will adopt a flexible approach in consultation with their treasury advisors, after consideration of the following:

- Affordability
- Maturity profile of existing debt
- Interest rate and refinancing risks
- Borrowing source

4.20 The General Fund revenue budget for 2022/23 will include provision for interest payments relating to external borrowing and the statutory Minimum Revenue Provision (MRP) to ensure the principal is repaid. Different arrangements apply to the Housing Revenue Account (Council Housing) in that there is no MRP. The strategy and activities are affected by a number of factors, including the regulatory framework, economic conditions, best practice and interest rate/liquidity risk. Appendices D, E, F, G, H and I summarise the regulatory framework, economic background and information on key activities for the year.

4.21 In accordance with the DLUHC Guidance, the Councils will be asked to approve a revised Treasury Management Strategy if the assumptions on which this report is based change significantly. Such circumstances would include, for example, a large, unexpected change in interest rates, or in the Councils’ capital programmes or in the level of investment balances.

Debt rescheduling

4.22 The PWLB allows authorities to repay loans before maturity and either pay a premium or receive a discount according to a set formula based on current interest rates. Other lenders may also be prepared to negotiate premature redemption terms. The Councils may take advantage of this and replace some loans with new loans, or repay loans without replacement, where this is expected to lead to an overall cost saving or a reduction in risk.

5. Annual Treasury Investment Strategy

5.1 The Councils hold significant invested funds, representing income received in advance of expenditure plus balances and reserves held. In the past twelve months, Babergh's treasury investment balances have ranged between £12.3m and £24.2m. Mid Suffolk's treasury investment balances ranged between £12.3m and £27.6m.

5.2 Balances fluctuated more than in previous years due to timing differences between funding to support Covid19 payments received from central Government and the payments being made by the Councils.

Objectives

5.3 CIPFA's TM Code requires the Councils to invest their treasury funds prudently, and to have regard to the security and liquidity of their investments before seeking the highest rate of return or yield. The Councils' objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income.

5.4 Cash that is likely to be spent in the short term is invested securely, for example with the government, other local authorities or selected high-quality banks, to minimise the risk of loss. Money that will be held for longer terms is invested more widely, including in bonds, shares and property, to balance the risk of loss against the risk of receiving returns below inflation. Both short-term and longer-term investments may be held in pooled funds, where an external fund manager makes decisions on which investments to buy and the Councils may request their money back at short or up to 90 days' notice.

5.5 Where balances are expected to be invested for more than one year, whilst the Councils aim to achieve a total return that is equal to or higher than the prevailing rate of inflation (in order to maintain the spending power of the sum invested) it may be harder to do so, as the inflation rate is currently increasing. However, the expectation is that this will be a short term position and that inflation will reduce after 2022/23.

5.6 Table 3 shows the planned level of investments for treasury management purposes over the medium-term. Long term investments are those made for more than one year. Cash and cash equivalents include money market funds and current bank accounts.

Table 3: Treasury management investments

Treasury Management Investments						
Babergh District Council	31.03.2021 Actual £m	31.03.2022 Forecast Outturn £m	31.03.2023 Budget £m	31.03.2024 Forecast £m	31.03.2025 Forecast £m	31.03.2026 Forecast £m
Long Term Investments	11.17	11.09	11.06	11.05	11.03	11.00
Cash and Cash Equivalents	1.84	2.00	2.00	2.00	2.00	2.00
Total TM Investments	**13.01**	**13.09**	**13.06**	**13.05**	**13.03**	**13.00**

Treasury Management Investments						
Mid Suffolk District Council	31.03.2021 Actual £m	31.03.2022 Forecast Outturn £m	31.03.2023 Budget £m	31.03.2024 Forecast £m	31.03.2025 Forecast £m	31.03.2026 Forecast £m
Long Term Investments	11.16	11.09	11.06	11.05	11.03	11.00
Cash and Cash Equivalents	3.02	2.00	2.00	2.00	2.00	2.00
Total TM Investments	**14.68**	**13.09**	**13.06**	**13.05**	**13.03**	**13.00**

Governance – Treasury Management:

5.7 Decisions on treasury management investment and borrowing are made daily and are delegated to the Assistant Director - Corporate Resources (the S151 Officer) and Finance staff, who must act in line with the Joint Treasury Management Strategy approved by Full Council in February each year.

5.8 There is a Joint Half Year and Joint Annual Outturn Report on treasury management activity presented to Council. The Joint Audit and Standards Committee is responsible for scrutinising treasury management decisions.

Negative interest rates

5.9 The COVID-19 pandemic increased the risk that the Bank of England might set its Bank Rate at or below zero, which could feed through to negative interest rates on all low risk, short-term investment options. Since investments cannot pay negative income, negative rates will be applied by reducing the value of investments. In this event, security will be measured as receiving the contractually agreed amount at maturity, even though this may be less than the amount originally invested. As the Bank of England increased rates in December 2021, this situation is now less likely.

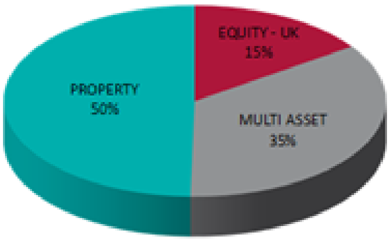
Strategy

5.10 Given the increasing risk and very low returns from short-term unsecured bank investments, both Councils have diversified into higher yielding asset classes. This diversification represents a continuation of the strategy adopted in 2015/16.

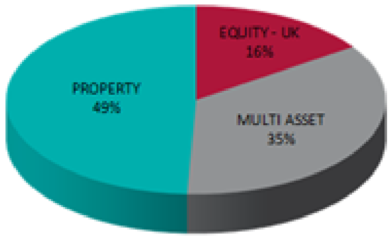
5.11 The value of these funds can fluctuate and they are therefore considered to be long term investments. The Councils have invested in a number of strategic pooled funds, across a variety of asset classes to minimise risk, as shown below.

Chart 1: Strategic pooled funds asset class allocation for both Councils

Babergh



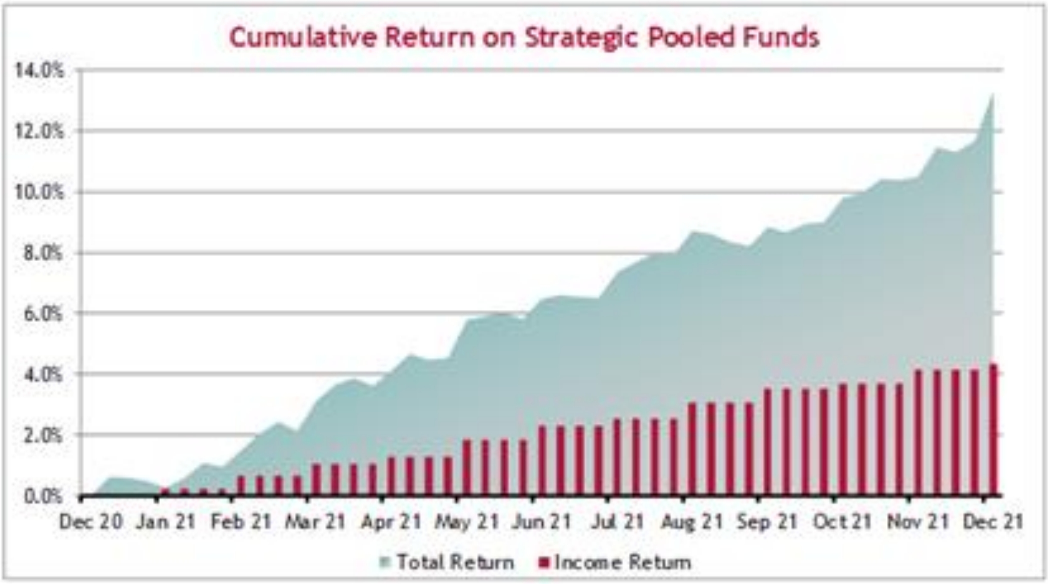
Mid Suffolk



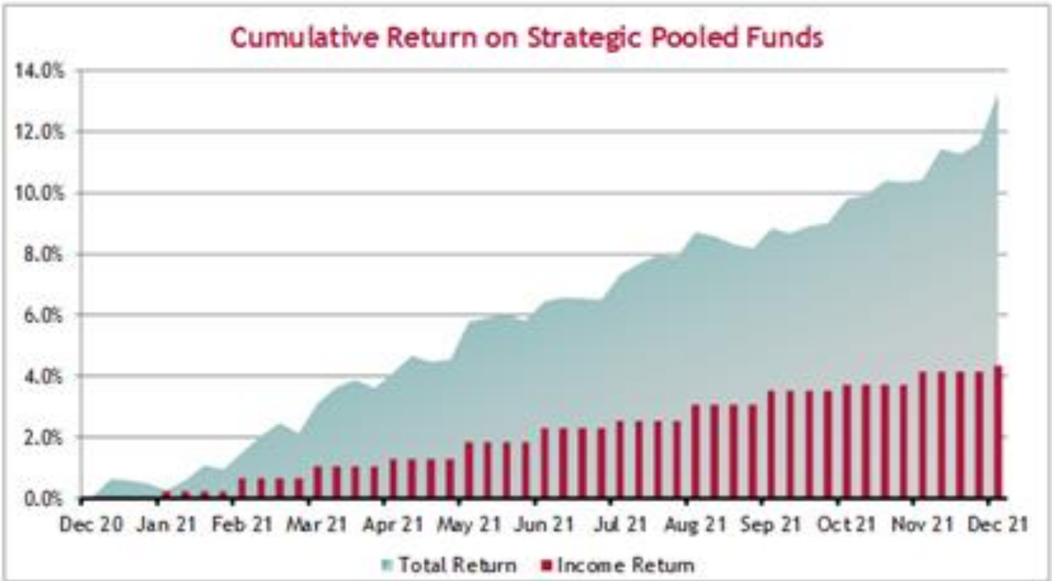
5.12 Although these funds have incurred unrealised capital losses, the overall total return for each has been positive with a total return of 13.3% for Babergh and 13.26% for Mid Suffolk in 2021 as illustrated in the following charts:

Chart 2: Cumulative return on strategic pooled funds

Babergh



Mid Suffolk



Environment, social and governance (ESG) issues

5.13 In 2019 the Councils declared a climate emergency with the ambition to make the Councils carbon neutral by 2030.

5.14 In light of climate change-related risks in particular, increasing attention is being given to responsible investment by investors globally, resulting in an increasing appreciation that assessing ESG factors is not only a moral issue to be addressed, but also a key part of understanding long-term investment risk.

5.15 The United Nations gives the following examples of ESG issues within its Principles for Responsible Investment;

Environmental
- Climate change
- Greenhouse gas emissions
- Resource depletion
- Waste and pollution
- Deforestation

Social
- Human rights
- Working conditions (including slavery and child labour)
- Local communities
- Employee relations and diversity

Governance
- Bribery and Corruption
- Board diversity and structure
- Executive pay
- Political lobbying and donations
- Tax strategy

5.16 An increasing number of ESG focussed funds are emerging that follow certain criteria for investments, such as abiding with the UN Principles of Responsible Investment, or not investing in certain industries such as weapons, fossil fuels or alcohol and tobacco.

5.17 Although regulations on ESG investments are gaining more clarity and standardisation, with the Government publishing a report in October 2021 called Greening Finance: A Roadmap to Sustainable Investing, careful due diligence is still required to ensure that a fund lives up to the claims being made and its ESG principles match the Councils' priorities for environmental / ethical investing.

5.18 The subject has been debated by both Joint Audit and Standards Committee in May 2021 and the Cabinets in January 2022. The Cabinets agreed to monitor treasury management investments in relation to all three aspects of ESG reporting as this develops and look to make changes to investments at an appropriate time that would strengthen ESG performance but be within acceptable financial considerations.

Business Models

5.19 Under the new IFRS 9 standard, accounting for certain investments depends on the Councils' "business model" for managing them. The Councils aim to achieve value from their internally managed treasury investments by a business model of collecting the contractual cash flows and therefore, where other criteria are also met, these investments will continue to be accounted for at amortised cost.

Approved counterparties

5.20 The minimum proposed investment criteria for UK counterparties in the 2022/23 Treasury Management Strategy remains at A-. (See Appendix I for a list). (Note: This would be the lowest credit rating determined by credit rating agencies).

5.21 In line with advice received from Arlingclose the Councils may invest surplus funds with any of the counterparty types in Table 4 that follows, subject to the cash limits (per counterparty) and the time limits shown.

Table 4: Approved investment counterparties and limits for Babergh and Mid Suffolk

Sector	Time limit	Counterparty limit	Sector limit
The UK Government	50 years	Unlimited	n/a
Local authorities & other government entities	25 years	£2m	100%
Secured investments *	25 years	£2m	100%
Banks (unsecured) *	13 months	£2m	100%
Building societies (unsecured) *	13 months	£2m	25%
Registered providers (unsecured) *	5 years	£1m	25%
Money market funds *	n/a	£2m	100%
Strategic pooled funds	n/a	£5m	100%
Other investments *	5 years	£1m	10%

Table 4 should be read in conjunction with the following notes:

- **Minimum Credit rating**
  Treasury investments in the sectors marked with an asterisk will only be made with entities whose lowest published long-term credit rating is no lower than A-. Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used. However, investment decisions are never made solely based on credit ratings, and all other relevant factors including external advice will be taken into account.

  For entities without published credit ratings, investments may be made either (a) where external advice indicates the entity to be of similar credit quality; or (b) as part of a diversified pool e.g. via a peer-to-peer platform.

- **Government**
  Loans to, and bonds and bills issued or guaranteed by, national governments, regional and local authorities and multilateral development banks. These investments are not subject to bail-in, and there is generally a lower risk of insolvency, although they are not zero risk. Investments with the UK Government are deemed to be zero credit risk due to its ability to create additional currency and therefore may be made in unlimited amounts for up to 50 years.

- **Secured investments**
  Investments secured on the borrower's assets, which limits the potential losses in the event of insolvency. The amount and quality of the security will be a key factor in the investment decision. Covered bonds and reverse repurchase agreements with banks and building societies are exempt from bail-in. Where there is no investment specific credit rating, but the collateral upon which the investment is secured has a credit rating, the higher of the collateral credit rating and the counterparty credit rating will be used. The combined secured and unsecured investments with any one counterparty will not exceed the cash limit for secured investments.

- **Banks and building societies (unsecured)**
  Accounts, deposits, certificates of deposit and senior unsecured bonds with banks and building societies, other than multilateral development banks. These investments are subject to the risk of credit loss via a bail-in should the regulator determine that the bank is failing or likely to fail. See below for arrangements relating to operational bank accounts.

- **Registered providers (unsecured)**
  Loans to, and bonds issued or guaranteed by, registered providers of social housing or registered social landlords, formerly known as housing associations. These bodies are regulated by the Regulator of Social Housing (in England), the Scottish Housing Regulator, the Welsh Government and the Department for Communities (in Northern Ireland). As providers of public services, they retain the likelihood of receiving government support if needed.

- **Money market funds**
  Pooled funds that offer same-day or short notice liquidity and very low or no price volatility by investing in short-term money markets. They have the advantage over bank accounts of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a small fee. Although no sector limit applies to money market funds, the Councils will take care to diversify its liquid investments over a variety of providers to ensure access to cash at all times.

- **Strategic pooled funds**
  Bond, equity and property funds that offer enhanced returns over the longer term but are more volatile in the short term. These allow the Council to diversify into asset classes other than cash without the need to own and manage the underlying investments. Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Councils' investment objectives will be monitored regularly.

- **Real estate investment trusts**
  Shares in companies that invest mainly in real estate and pay the majority of their rental income to investors in a similar manner to pooled property funds. As with property funds, REITs offer enhanced returns over the longer term, but are more volatile especially as the share price reflects changing demand for the shares as well as changes in the value of the underlying properties.

- **Other investments**

  This category covers treasury investments not listed above, for example unsecured corporate bonds and company loans. Non-bank companies cannot be bailed-in but can become insolvent placing the Councils' investment at risk.

Council banker and Operational bank accounts

5.22 The Councils may incur operational exposures, for example through current accounts, collection accounts and merchant acquiring services, to any UK bank with credit ratings no lower than BBB- and with assets greater than £25 billion. These are not classed as investments but are still subject to the risk of a bank bail-in, and balances will therefore be kept below £2m per bank. The Bank of England has stated that in the event of failure, banks with assets greater than £25 billion are more likely to be bailed-in than made insolvent, increasing the chance of the Councils maintaining operational continuity. Both Councils bank with Lloyds Bank plc which currently has a credit rating of A+.

Risk assessment and credit ratings

5.23 Credit ratings are obtained and monitored by the Councils treasury advisers, who will notify changes in ratings as they occur. The credit rating agencies in current use are listed in the Treasury Management Practices document. Where an entity has its credit rating downgraded so that it fails to meet the approved investment criteria then:

- no new investments will be made,
- any existing investments that can be recalled or sold at no cost will be, and
- full consideration will be given to the recall or sale of all other existing investments with the affected counterparty.

5.24 Where a credit rating agency announces that a credit rating is on review for possible downgrade (also known as "negative watch") so that it may fall below the approved rating criteria, then only investments that can be withdrawn on the next working day will be made with that organisation until the outcome of the review is announced. This policy will not apply to negative outlooks, which indicate a long-term direction of travel rather than an imminent change of rating.

5.25 See the table in Appendix I for an explanation of the credit ratings issued by the main credit ratings agencies.

Other information on the security of investments

5.26 The Councils understand that credit ratings are good, but not perfect, predictors of investment default. Full regard will therefore be given to other available information on the credit quality of the organisations in which it invests, including credit default swap prices, financial statements, information on potential government support, reports in the quality financial press and analysis and advice from the Councils treasury management adviser. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may otherwise meet the above criteria.

5.27 When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008 and 2020, this is not generally reflected in credit ratings, but can be seen in other market measures. In these circumstances, the Councils will restrict investments to those organisations of higher credit quality and reduce the maximum duration of investments to maintain the required level of security. The extent of these restrictions will be in line with prevailing financial market conditions.

5.28 If these restrictions mean that insufficient commercial organisations of high credit quality are available to invest the Councils' cash balances, then the surplus will be deposited with the UK Government via the Debt Management Office (DMADF) or invested in government treasury bills for example, or with other local authorities. This will cause investment returns to fall but will protect the principal sum invested.

Investment limits

5.29 The Councils' total General Fund reserves available to cover investment losses are forecast to be £6.7m for Babergh and £18.5m for Mid Suffolk on 31 March 2022. In order to minimise the available reserves that would be put at risk in the case of a single default, the maximum that will be lent to any one organisation (other than the UK Government) for the majority of sectors will be £2m.

5.30 A group of entities under the same ownership will be treated as a single organisation for limit purposes. Limits are also placed on fund managers, investments in brokers' nominee accounts, foreign countries and industry sectors as per Table 5. Investments in pooled funds and multilateral development banks do not count against the limit for any single foreign country, as the risk is diversified over many countries.

5.31 Credit risk exposures arising from non-treasury investments, financial derivatives and operational bank accounts count against the relevant investment limits.

Table 5: Additional Investment limits for Babergh and Mid Suffolk

Investment Limits	Cash limit
Any group of pooled funds under the same management	£5m per manager
Negotiable instruments held in a broker's nominee account	£10m per broker
Foreign countries	£2m per country

Liquidity management

5.32 The Councils use purpose-built cash flow forecasts to determine the maximum period for which funds may prudently be committed. The forecast is compiled on a prudent basis to minimise the risk of the Councils being forced to borrow on unfavourable terms to meet its financial commitments. Limits on long-term investments are set by reference to the Councils medium-term budget planning and cash flow forecasts.

5.33 The Councils will spread their liquid cash over at least four providers (e.g. bank accounts and money market funds) to ensure that access to cash is maintained in the event of operational difficulties at any one provider.