

Herefordshire Council

Treasury Management Strategy 2018/19

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Treasury Management Strategy Statement 2018/19

1. Introduction

- 1.1 The Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice 2017 Edition* (the CIPFA Code) requires the council to approve a Treasury Management Strategy Statement (TMS) before the start of each financial year. The TMS also includes the Annual Investment Strategy as required under Investment Guidance provided by Communities and Local Government (CLG).
- 1.2 The council borrows and invests substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk are therefore central to the council's treasury management strategy.
- 1.3 The purpose of this TMS is to approve:
- Treasury Management Strategy for 2018/19
 - Borrowing – Section 5
 - Investments – Section 6
 - Minimum Revenue Payment (MRP) Statement – Section 7
 - Prudential Indicators - Appendix c

2. Summary of Strategy for 2018/19

Borrowing

- 2.1 In 2018/19 council borrowing is estimated to increase by £18.1m from £257.8m to £275.9m. This increase can be analysed as follows.

	£m
Estimated council borrowing as at 31st March 2018	257.8
Capital investment funded by borrowing	28.2
Less: Provision for Repayment of Principal (MRP)	(8.2)
Less: EfW principal loan repayments due	(1.4)
MRP overprovision adjustment	(0.5)
Estimated council borrowing as at 31st March 2019	275.9

- 2.2 Any borrowing requirements will be financed by short term borrowing. Short-term rates are currently significantly lower than longer-term rates and long-term analysis, comparing short-term finance with a long-term loan, has shown this to be the most

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cost effective approach with savings in the early years outweighing additional amounts payable that may fall due in later years.

- 2.3 The borrowing budget for 2018/19 includes provision to pay short-term interest rates of up to 1.5% (including brokers commission), we currently secure short term at 0.8%. The budget also includes the interest cost on existing fixed term borrowing.
- 2.4 Compared to a 20 year EIP loan (currently at 2.23%) using short-term finance (at 1.5%) interest cost incurred could be £0.2m lower in 2018/19 (using an estimated average amount of short-term debt outstanding during 2018/19 of £30m).
- 2.5 If no longer term PWLB loans are taken out, by 31st March 2019 variable rate short-term loans may total £30m (17%) compared to fixed rate longer-term borrowing of £145.6m. This strategy approves a total variable loan stock holding of up to 50% of total loans to minimise the risk of interest rate increases.
- 2.6 The council's exposure to variable rate debt has been discussed with the council's treasury adviser, Link Asset Services, who agree with the council's borrowing policy and the consideration of our interest rate forecasting.

Investments

- 2.7 As a result of current banking regulations which, in the absence of government support, put the council's deposits at risk when banks get into difficulty, the council will:
 - Maintain lower investment balances during the year;
 - Keep low but liquid cash balances and invest these mainly in Money Market Funds;
 - Maintain counterparty limits with the banks at prudent levels;
 - Consider other creditworthy investments to increase diversification.

3. Economic Background and Interest Rate Forecast

Economic background

- 3.1 **UK.** After strong economic growth in 2016, growth in 2017 has been weak; quarter 1 +0.3% (+1.8% y/y), quarter 2 +0.3% (+1.5% y/y) and quarter 3 +0.4% (+1.5% y/y). The main reason for this has been the sharp increase in inflation, caused by the devaluation of sterling after the EU referendum, feeding increases in the cost of imports into the economy. This has caused, in turn, a reduction in consumer disposable income and spending power and so the services sector of the economy, accounting for around 80% of GDP, has seen weak growth as consumers cut back on their expenditure. However, more recently there have been encouraging statistics from the manufacturing sector which is seeing strong growth, particularly as a result of increased demand for exports. However, this sector only accounts for around 10% of GDP so expansion in this sector will have a muted effect on the overall GDP growth figure for the UK economy as a whole.

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- 3.2 The Bank of England is expected to give forward guidance to prepare financial markets for gradual changes in policy, the Monetary Policy Committee, (MPC), meeting of 14 September 2017 warned that the Bank Rate will need to rise soon. The Bank of England Inflation Reports during 2017 expected CPI inflation to peak at just under 3% in 2017, before falling back to near to its target rate of 2% in two years' time. The Bank revised its forecast for the peak to just over 3% at the 14 September meeting. (Inflation actually came in at 3.0% in both September and October).
- 3.3 At the 2 November meeting, the MPC delivered a 0.25% increase in the Bank Rate. It also gave forward guidance that they expected to increase the Bank Rate only twice more in the next three years to reach 1.0% by 2020. This is in line with previous statements that Bank Rate would only go up gradually and to a limited extent.
- 3.4 However, some forecasters are flagging up that they expect growth to accelerate significantly towards the end of 2017 and then into 2018. If this scenario was to materialise, then the MPC would be likely to accelerate its pace of increases in Bank Rate during 2018 and onwards.
- 3.5 It is a concern that some consumers may have become complacent about interest rates going up after Bank Rate had been unchanged at 0.50% since March 2009 until falling further to 0.25% in August 2016. This is why forward guidance from the Bank of England continues to emphasise slow and gradual increases in Bank Rate in the coming years. Moreover, while there is uncertainty around the Brexit negotiations, consumer confidence, and business confidence to spend on investing, it is too early to be confident about how the next two to three years will actually pan out.
- 3.6 **EZ.** Economic growth in the eurozone (EZ), (the UK's biggest trading partner), had been lack lustre for several years after the financial crisis despite the ECB eventually cutting its main rate to -0.4% and embarking on a massive programme of QE. However, growth picked up in 2016 and has now gathered substantial strength and momentum thanks to this stimulus. GDP growth was 0.6% in quarter 1 (2.0% y/y), 0.7% in quarter 2 (2.3% y/y) and +0.6% in quarter 3 (2.5% y/y). However, despite providing massive monetary stimulus, the European Central Bank is still struggling to get inflation up to its 2% target and in October inflation was 1.4%. It is therefore unlikely to start on an upswing in rates until possibly 2019. It has, however, announced that it will slow down its monthly QE purchases of debt from €60bn to €30bn from January 2018 and continue to at least September 2018.
- 3.7 **USA.** Growth in the American economy was notably erratic and volatile in 2015 and 2016. 2017 is following that path again with quarter 1 coming in at only 1.2% but quarter 2 rebounding to 3.1% and quarter 3 coming in at 3.0%. Unemployment in the US has fallen to the lowest level for many years, reaching 4.1%, while wage inflation pressures, and inflationary pressures in general, have been building. The Fed has started on a gradual upswing in rates with four increases in all and three increases since December 2016; and there could be one more rate rise in 2017, which would then lift the central rate to 1.25 – 1.50%. There could then be another four increases in 2018. At its September meeting, the Fed said it would start in October to gradually unwind its \$4.5 trillion balance sheet holdings of bonds and mortgage backed securities by reducing its reinvestment of maturing holdings.

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Interest rate forecast

- 3.8 Investment returns are likely to remain low during 2018/19 but to be on a gently rising trend over the next few years.
- 3.9 Borrowing interest rates increased sharply after the result of the general election in June and then also after the September MPC meeting when financial markets reacted by accelerating their expectations for the timing of Bank Rate increases. The policy of avoiding new borrowing by running down spare cash balances has proved efficient and will continue to be carefully reviewed to minimise the risk of incurring higher borrowing costs in the future;
- 3.10 There will remain a cost of carry to any new long-term borrowing that causes a temporary increase in cash balances as this position will, most likely, incur a revenue cost – being the difference between higher borrowing costs and lower investment returns.
- 3.11 A more detailed interest rate forecast provided by the Link Asset Services is attached at **Appendix d**.

4 Capital Financing Requirement

- 4.1 Capital expenditure can be financed in a number of ways including the application of usable capital receipts, a direct charge to revenue, capital grant or by securing an up-front contribution towards the cost of a project.
- 4.2 Capital expenditure not financed by one of the above methods will increase the capital financing requirement (CFR) of the council.
- 4.3 The CFR reflects the council's underlying need to finance capital expenditure by borrowing or by other long-term liability arrangements, for example public finance initiatives.
- 4.4 The use of the term "borrowing" in this context does not necessarily imply external debt since, in accordance with best practice, the council has an integrated treasury management strategy. Borrowing is not associated with specific capital expenditure. The council will, at any point in time, have a number of cash flows both positive and negative and will be managing its position in terms of its borrowings and investments in accordance with its treasury management strategy.
- 4.5 The forecast movement in the CFR over future years is one of the Prudential Indicators which can be found in Appendix c. The movement in actual external debt and usable reserves (which have a direct bearing on when any internal borrowing may need to be externalised) combine to identify the council's borrowing requirement and potential investment strategy in the current and future years.

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	31.03.18 Estimate £000	31.03.19 Estimate £000	31.03.20 Estimate £000	31.03.21 Estimate £000
CFR excluding other long-term liabilities and MRP provision and grants	288,724	307,307	328,395	324,345
Less: Existing Profile of Longer Term Borrowing – PWLB and bank loans	(143,011)	(137,517)	(130,282)	(126,798)
Cumulative Maximum External Borrowing Requirement	145,713	169,790	234,473	235,250
Internal borrowing	(30,000)	(30,000)	(20,000)	(20,000)
EfW loan repayments	(957)	(1,377)	(1,372)	(1,342)
Cumulative Net Borrowing Requirement	81,156	138,413	213,101	213,908
Total Council Borrowing	257,767	275,930	343,383	340,706

- 4.6 The above table shows the council's net borrowing requirement over and above its existing long-term loan finance. Part of this requirement relates to the refinancing of principal repaid on long-term EIP and annuity loans with the balance relating to additions to the capital programme financed by borrowing.
- 4.7 The increase in the capital financing, and associated borrowing, requirement over the period reflects the inclusion of new borrowing to fund future capital investment through the capital programme. This is at a higher rate than the minimum revenue provision required to be set aside to reflect the repayment of capital investment already made. The majority of borrowing used to fund capital investment is made on a funded basis where the cost of borrowing is funded through savings or income due, for example the historic investment in leisure centres, the continued investment in the enterprise zone and the proposed investment in the development partnership.

5 Borrowing Strategy

- 5.1 At 30 November 2017 the council held £160.6m of loans, comprising long-term fixed rate loans totalling £145.6m plus short-term loans from local authorities of £15m. The balance sheet forecast in table 1 shows that the council's borrowing may need to increase to £257.8m by 31 March 2018 and to £275.9m by 31 March 2019, assuming the timing and levels of capital expenditure are as budgeted.

Objective

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

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Strategy

- 5.3 Given the significant cuts to public expenditure and in particular to local government funding, the council's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. With short-term interest rates currently much lower than long-term rates, it is more cost effective in the short-term to use internal resources and borrow using short-term loans.
- 5.4 This enables the council to reduce net borrowing costs (despite foregone investment income) and reduce overall credit risk by tailoring the timing of borrowing so as to minimise balances held. The benefits of internal 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. The councils treasury advisors will assist the council with 'cost of carry' and breakeven analysis. Its output will determine whether the council borrows additional sums at long-term fixed rates in 2018/19 with a view to keeping future interest costs low, even if this causes additional cost in the short-term.
- 5.5 Short-term loans leave the council exposed to the risk of short-term interest rate rises; they are therefore subject to the limit on the net exposure to variable interest rates in the treasury management indicators below.

Sources

- 5.6 The approved sources of long-term and short-term borrowing are:
- Public Works Loan Board (PWLB)
 - UK local authorities
 - any institution approved for investments (see below)
 - any other bank or building society authorised to operate in the UK
 - UK public and private sector pension funds
 - capital market bond investors
 - Local Capital Finance Company and other special purpose companies created to enable local authority bond issues.
- 5.7 In addition, capital finance may be raised by the following methods that are not borrowing, but may be classed as other debt liabilities:
- operating and finance leases
 - hire purchase
 - Private Finance Initiative
 - sale and leaseback

LOBO loans

- 5.8 The council has two LOBO loans (Lender's Option Borrower's Option) of £6m each on which the council pays interest at 4.5%. Every six months, when the interest

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charges become due, the lenders have the option to increase the interest rate being charged at which point the council can accept the revised terms or reject them and repay the loan. LOBO loans present a potential refinancing risk to the council since the decision to amend the terms is entirely at the lender's discretion.

Debt rescheduling

- 5.9 The PWLB allows the repayment of loans before maturity by either paying a premium or receiving a discount according to a set formula based on current interest rates. Due to the prevailing low interest rate regime, opportunities for debt rescheduling are likely to be very limited. However, this option will be kept under review and will be considered where this is expected to lead to an overall saving or reduction in risk.

6 Investment Strategy

- 6.1 The council needs to hold adequate funds to meet day to day liquidity needs, for example salary and creditor payments. The council hold balances of around £15m to cover all contingencies. A cash flow forecast is maintained that includes all known receipts and payments so that the council can take action to ensure that it can meet all its liabilities when they fall due.

Objective

- 6.2 Both the CIPFA Code and the CLG Guidance require the Authority to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The council's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and receiving unsuitably low investment income.

Following the introduction of MIFID II (The Markets in Financial Instruments Directive), in January 2018, being the framework of European Union legislation for:

- investment intermediaries that provide services to clients around shares, bonds, units in collective investment schemes and derivatives (collectively known as 'financial instruments'), and
- the organised trading of financial instruments

Herefordshire Council has opted up to "professional status". There are several criteria that must be met to be able to opt up from retail to professional status, with the key one being to have a total investment portfolio of over £10m. Opting up permits uninterrupted advice on as wide a range of investment / debt products that may be considered as part of our Treasury Management process. Our status has been confirmed with all counterparties where this applies. These arrangements will be regularly reviewed as appropriate.

Strategy

- 6.3 Given the increasing risk and continued low returns from short-term unsecured bank deposits, the council will aim to keep its invested funds as low as possible and

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reduce the amounts invested with banks and building societies. For 2018/19 the council will continue to rely on Money Market Funds which are highly diversified and carry reduced credit risk.

Risk Assessment and Credit Ratings

- 6.4 The council applies the credit worthiness service provided by Link Asset Services. This service employs a sophisticated modelling approach utilising credit rating from three main credit rating agencies (Fitch, Moody's and Standard and Poor's). This modelling approach combines credit ratings, credit watches and credit outlooks in a weighted scoring system to which Link Asset Services allocate a series of colour coded bands with suggested maximum durations for investments (as shown in table 2 below).
- 6.5 Typically the minimum credit ratings criteria the council use will be short term rating (Fitch or equivalents) of F1 and a long term rating of A-. There may be occasions when the counterparty ratings from one agency are marginally lower than these ratings but still may be used. In these instances consideration will be given to the whole range of ratings available, or other topical market information, to support their use.
- 6.6 The council has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of AA- (Fitch or equivalents). Currently these countries are:
- Australia (AAA)
 - Canada (AAA)
 - Denmark (AAA)
 - Germany (AAA)
 - Luxembourg (AAA)
 - Netherlands (AAA)
 - Norway (AAA)
 - Singapore (AAA)
 - Sweden (AAA)
 - Switzerland (AAA)
 - Finland (AA+)
 - Hong Kong (AA+)
 - U.S.A. (AA+)
 - Abu Dhabi (AA)
 - France (AA)
 - UK (AA)
 - Belgium (AA-)
 - Qatar (AA-)

Approved Counterparties

- 6.7 The council will invest its surplus funds with any of the counterparty types in table 2 below, subject to the cash limits (per counterparty) and the time limits shown.

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Table 2: Approved Investment Counterparties and Limits

		Colour coding or long term rating	£ limit	Time limit
Banks and Building Societies	Term deposits, CDs or corporate bonds	Yellow Purple Orange Blue Red Green No colour	5m 5m 5m 5m 5m 5m nil	5 years 2 years 1 year 1 year 6 months 100 days Not to be used
Council's Banker (NatWest)			5m	Liquid
DMADF	DMADF account	AAA	Unlimited	6 months
UK Government	UK Gilts	UK sovereign rating	Unlimited	1 year
UK Government	Treasury Bills	UK sovereign rating	Unlimited	1 year
Multilateral development banks	Bonds	AAA	5m	6 months
Local Authorities	Term deposits		5m	1 year
Money Market Funds	MMFs	AAA	5m	Liquid
Enhanced Money Market Funds with a credit score of 1.25	MMFs	Dark pink / AAA	5m	Liquid
Enhanced Money Market Funds with a credit score of 1.5	MMFs	Light pink / AAA	5m	Liquid
Other investments:				
Pooled funds		£5m per fund		
Mercia Waste Management (providing finance for Energy from Waste Plant)		£40m over the course of the contract		

Specified Investments

6.8 The CLG Guidance defines specified investments as those:

- denominated in pound sterling,
- due to be repaid within 12 months of arrangement,
- not defined as capital expenditure by legislation, and
- invested with one of:
 - the UK Government,
 - a UK local authority, parish council or community council, or
 - a body or investment scheme of "high credit quality".

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- 6.10 The Authority defines “high credit quality” organisations and securities as those having a credit rating of A- or higher that are domiciled in the UK or a foreign country with a sovereign rating of AA- or higher.

Non-specified Investments

- 6.11 Any investment not meeting the definition of a specified investment is classed as non-specified. The Authority does not intend to make any investments denominated in foreign currencies, nor any that are defined as capital expenditure by legislation, such as company shares. Non-specified investments will therefore be limited to long-term investments, i.e. those that are due to mature 12 months or longer from the date of arrangement, and investments with bodies and schemes not meeting the definition on high credit quality. Limits on non-specified investments are shown in table 3 below.

Table 3: Non-Specified Investment Limits	
	Cash limit
Total long-term investments	£5m
Total investments with unrecognised credit ratings	£2.5m
Total non-specified investments	£7.5m

7. Annual Minimum Revenue Provision Statement 2018/19

- 7.1 Where the council finances capital expenditure by debt, it must put aside resources to repay that debt in later years. The amount charged to the revenue budget for the repayment of debt is known as Minimum Revenue Provision (MRP). The Local Government Act 2003 requires the council to have regard to the Department for Communities and Local Government’s Guidance on Minimum Revenue Provision (the CLG Guidance) most recently issued in 2012. The broad aim of the CLG Guidance is to ensure that debt is repaid over a period that is either reasonably commensurate with that over which the capital expenditure provides benefits. In line with the CLG Guidance, the policy for the 2018/19 calculation of MRP is as follows:

	Indicative 2018/19 MRP charge £000
Supported borrowing	1,290
Prudential borrowing pre 1 April 2008	2,394
Prudential borrowing post 1 April 2008	4,662
Overprovision adjustment	(519)
Finance leases and private finance initiatives	369
TOTAL	8,196

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MRP on all capital expenditure incurred before 1 April 2008, and on expenditure funded by supported borrowing thereafter, will be equal to 4% of the opening capital financing requirement with some optional adjustments.

MRP on expenditure incurred from 1 April 2008 onwards that is funded by unsupported “prudential” borrowing will be calculated by reference to the asset’s useful life, using either an annuity method, starting in the year after the asset becomes operational.

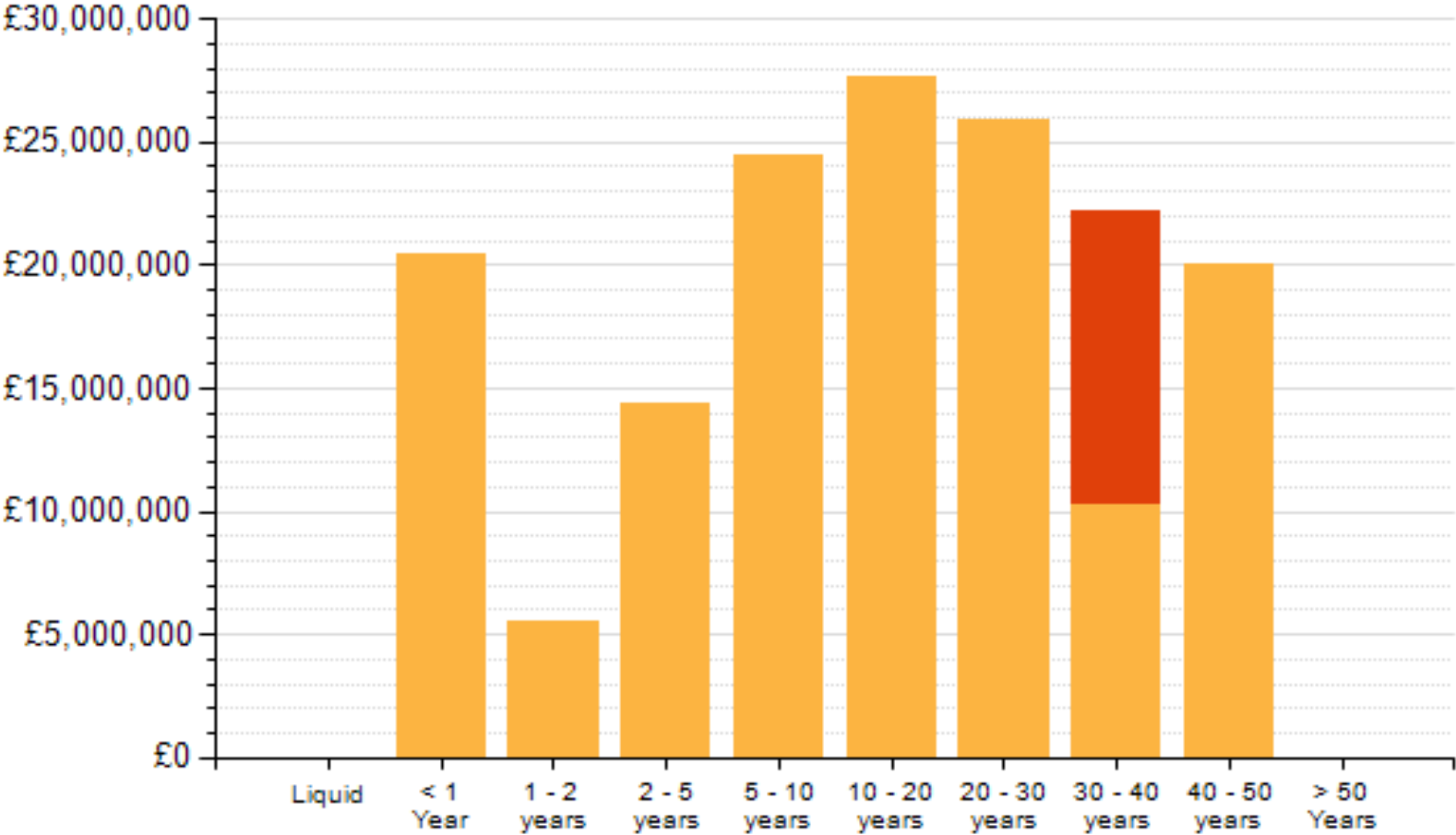
MRP on assets acquired through finance leases and Private Finance Initiative (PFI) will be equal to the cash payments that reduce the outstanding liability each year.

EXISTING BORROWING & INVESTMENTS AS AT 30 NOVEMBER 2017

External Borrowing:	Actual Portfolio £m	Average Rate %
<u>Long-term loans (all fixed rate)</u>		
Public Works Loan Board	133.6	3.83%
LOBO Loans	12.0	4.50%
<u>Short-term loans</u>		
Local Authorities	15.0	0.58%
Total External Borrowing	160.6	3.58%

Investments:	Actual Portfolio £m	Average Rate %
Santander (95 day notice account)	5.0	1.00%
Money Market Funds (Instant Access)	11.8	0.34%
Fixed Term Deposits (Local Authorities)	10.0	0.35%
Total Investments	26.8	0.47%

Loans Maturities by Type



PRUDENTIAL INDICATORS**1. Background**

There is a requirement under the Local Government Act 2003 for local authorities to have regard to CIPFA's Prudential Code for Capital Finance in Local Authorities (the Prudential Code) when determining how much money it can afford to borrow. The objectives of the Prudential Code are to ensure that the capital investment plans of local authorities are affordable, prudent and sustainable, and that treasury management decisions are taken in accordance with good professional practice. To demonstrate that the Authority has fulfilled these objectives, the Prudential Code sets out the following indicators that must be set and monitored each year.

2. Estimates of Capital Expenditure

- 2.1 This indicator is set to ensure that the level of proposed capital expenditure remains within sustainable limits and, in particular, to consider the impact on Council Tax levels.

Capital Programme	2017/18 £000	2018/19 Estimate £000	2019/20 Estimate £000	2020/21 Estimate £000
Existing approvals	73,272	65,938	36,911	8,317
2018/19 additions	-	26,210	11,000	-
Total expenditure	73,272	92,148	47,911	8,317
Funding				
Capital receipts	9,745	12,495	150	-
Capital Grants	39,071	51,497	22,213	8,317
Prudential Borrowing	24,456	28,156	25,547	-
Total	73,272	92,148	47,910	8,317

3. Capital Financing Requirement

- 3.1 The Capital Financing Requirement (CFR) measures the council's underlying need to borrow for a capital purpose. The calculation of the CFR is taken from the amounts held in the Balance Sheet relating to capital expenditure and financing. The table below includes PFI contracts:

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4.	Capital Financing Requirement	2018/19 Estimate £000	2019/20 Estimate £000	2020/21 Estimate £000
	Total CFR	307,307	328,395	324,345

Gross Debt and the Capital Financing Requirement

4.1 In order to ensure that over the medium term debt will only be for a capital purpose, the local authority should ensure that debt does not, except in the short term, exceed the total of the capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years.

4.2 The Section 151 Officer reports that the council currently has no difficulty meeting this requirement nor are there any difficulties envisaged for future years. This view takes into account current commitments, existing plans and the proposals in the approved budget.

5. Operational Boundary for External Debt

5.1 The operational boundary is based on the Authority's estimate of the most likely (i.e. prudent but not worst case) level for external debt. It links directly to the Authority's estimates of capital expenditure, the capital financing requirement and cash flow requirements, and is a key management tool for in-year monitoring. Other long-term liabilities comprise finance lease, Private Finance Initiative and other liabilities that are not borrowing but form part of the council's debt.

Operational Boundary	2018/19 Estimate £m	2019/20 Estimate £m	2020/21 Estimate £m
Operational Boundary for Borrowing	270	290	290
Operational Boundary for other Long-Term Liabilities	60	60	60
Operational Boundary for External Debt	330	350	350

6. Authorised Limit for External Debt

6.1 The authorised limit is the affordable borrowing limit determined in compliance with the Local Government Act 2003. It is the maximum amount of debt that the Authority can legally owe. The authorised limit provides headroom over and above the operational boundary for unusual cash movements.

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Authorised Limit	2018/19 Estimate £m	2019/20 Estimate £m	2020/21 Estimate £m
Authorised Limit for Borrowing	290	310	310
Authorised Limit for other Long-Term Liabilities	70	70	70
Authorised Limit for External Debt	360	380	380

7. Ratio of Financing Costs to Net Revenue Stream

7.1 This is an indicator of affordability and highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet financing costs. The definition of financing costs is set out in the Prudential Code and includes both interest payable and provision for repayment of loan principal.

7.2 The ratio is based on costs net of investment income.

Ratio of Financing Costs to Net Revenue Stream	2018/19 Estimate £'000	2019/20 Estimate £'000	2020/21 Estimate £'000
Net Revenue Stream	144,124	142,345	151,766
Financing Costs	13,880	12,821	12,241
Percentage	9.6%	9.0%	8.0%

7.3 The above table shows budgeted financing costs within the council's medium term financial strategy and reflects the revised MRP policy approved by Council in October 2017.

9. Adoption of the CIPFA Treasury Management Code

9.1 This indicator demonstrates that the council has adopted the principles of best practice.

9.2 The council has incorporated the changes from the revised CIPFA Code of Practice into its treasury policies, procedures and practices. The council's Treasury Management Policy Statement is attached at Appendix e.

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10. Upper Limits for Fixed Interest Rate Exposure and Variable Interest Rate Exposure

10.1 These indicators allow the council to manage the extent to which it is exposed to changes in interest rates.

10.2 Due to the large difference between short-term and longer-term interest rates, the limit has been increased to accommodate the council financing the capital programme by short-term variable rate borrowing. Interest rates are forecast to remain low for the next few years and analysis (comparing a twenty year loan with short-term borrowing over the same period) indicates that short-term savings in the next few years will exceed any increased amounts payable in five to ten years time. In pursuing this policy the council recognises that it is more exposed to an unexpected hike in interest rates but the benefits of affordability and flexibility (enabling the council to reduce its short-term borrowing either to reduce cash investments at times of heightened credit risk or when the borrowing can be replaced by the proceeds from fixed asset sales) outweigh the increased interest rate risk.

	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate
Upper Limit for Fixed Interest Rate Exposure	100%	100%	100%
Upper Limit for Variable Interest Rate Exposure	50%	50%	50%

11. Maturity Structure of Fixed Rate Borrowing

11.1 The council will also limit and monitor large concentrations of fixed rate debt needing to be replaced. Limits in the following table are intended to control excessive exposures to volatility in interest rates when refinancing maturing debt.

11.2 The maturity of borrowing is determined by reference to the date on which the loans could be repaid. The council's two LOBO loans could become repayable within 12 months although, if the lenders do not increase the interest rates being charged, which is the current assumption, then the loans could remain outstanding until 2054.

Maturity structure of fixed rate borrowing	Estimated level at 31/03/18	Lower Limit for 2018/19	Upper Limit for 2018/19
Under 12 months	4%	0%	35%
12 months and within 24 months	3%	0%	30%
24 months and within 5 years	6%	0%	25%
5 years and within 10 years	23%	0%	25%

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Maturity structure of fixed rate borrowing	Estimated level at 31/03/18	Lower Limit for 2018/19	Upper Limit for 2018/19
10 years and within 20 years	18%	0%	40%
20 years and within 30 years	16%	0%	40%
30 years and within 40 years	26%	0%	40%
40 years and within 50 years	4%	0%	40%
Total	100%		

12. Upper Limit for total principal sums invested over 364 days:

- 12.1 The purpose of this limit is to contain exposure to the possibility of loss that may arise as a result of the council having to seek early repayment of the sums invested.

Upper Limit for total principal sums invested over 364 days	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate
	£m	£m	£m
	5	5	5

**OUTLOOK FOR INTEREST RATES
(FORECAST & ECONOMIC COMMENT PROVIDED BY TREASURY ADVISORS)**

	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
Bank Base Rate (%)	0.50	0.50	0.50	0.50	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.25	1.25
PWLB Rates (%):													
5 years	1.60	1.60	1.70	1.80	1.80	1.90	1.90	2.00	2.10	2.10	2.20	2.30	2.30
10 years	2.20	2.30	2.40	2.40	2.50	2.60	2.60	2.70	2.70	2.80	2.90	2.90	3.00
25 years	2.90	3.00	3.00	3.10	3.10	3.20	3.20	3.30	3.40	3.50	3.50	3.60	3.60
50 years	2.60	2.70	2.80	2.90	2.90	3.00	3.00	3.10	3.20	3.30	3.30	3.40	3.40
The above PWLB rates are noted by Link Asset Services as being their “central” or most likely forecast, however, they also note that there are upside and downside risks to their forecast.													

Forecast:

- The council’s treasury advisors forecast the bank base rate to stay on hold until quarter one of 2019 at which point small stepped increases are anticipated. It is anticipated the bank base rate standing at 1.25% at March 2021. Capital Economics forecast that interest rates will increase more rapidly with the next increase in quarter two of 2018 and with the bank base rate standing at 1.75% at December 2019.

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Council budget:

- As can be seen from the table above, the council's treasury advisors central forecast is for the Bank Base Rate to remain at 0.50% for the majority of 2018/19 possibly increasing to 0.75% at the end of the financial year. The council's short-term borrowing budget has been based on a rate of up to 1.5% which should incorporate sufficient headroom to accommodate any unexpected changes in the Base Rate.
- The investment budget is based on the majority of funds being held in instant access accounts generating low returns.
- Should the Bank Base Rate increase sooner or more rapidly than forecast the increased yield on investments will partly offset any increase in short-term variable rates.

TREASURY MANAGEMENT POLICY STATEMENT

1. Statement of Purpose

- 1.1 Herefordshire council adopts the recommendations made in CIPFA's *Treasury Management in the Public Services: Code of Practice*, which was revised in 2017. In particular, the council adopts the following key principles and clauses.

2. Key Principles

- 2.1 Herefordshire council adopts the following three key principles (identified in Section 4 of the Code):
- The council will put in place formal and comprehensive objectives, policies and practices, strategies and reporting arrangements for the effective management and control of its treasury management activities.
 - The council will ensure that its policies and practices make clear that the effective management and control of risk are prime objectives of its treasury management activities and that responsibility for these lies clearly with the council. In addition, the council's appetite for risk will form part of its annual strategy and will ensure that priority is given to security and liquidity when investing funds.
 - The council acknowledges that the pursuit of best value in treasury management, and the use of suitable performance measures, are valid and important tools to employ in support of business and service objectives, whilst recognising that in balancing risk against return, the council is more concerned to avoid risks than to maximise returns.

3. Adopted Clauses

- 3.1 Herefordshire council formally adopts the following clauses (identified in Section 5 of the code):
- The council will create and maintain, as the cornerstones for effective treasury management:
 - A treasury management policy statement, stating the policies, objectives and approach to risk management of its treasury management activities;
 - Suitable treasury management practices (TMPs), setting out the manner in which the organisation will seek to achieve those policies and objectives, and prescribing how it will manage and control those activities.

The content of the policy statement and TMPs will follow the recommendations contained in Sections 6 and 7 of the Code, subject only to amendment where necessary to reflect the particular circumstances of the council. Such amendments will not result in the organisation materially deviating from the Code's key principles.

- Full council will receive reports on treasury management policies, practices and activities, including, as a minimum, an annual strategy and plan in advance of the year, a mid-year review and an annual report after its close.

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- The responsibility for the implementation and regular monitoring of treasury management policies and practices is delegated to Cabinet and for the execution and administration of treasury management decisions to the Chief Officer-Finance and Commercial, who will act in accordance with the organisation's policy statement and TMPs and, if he or she is a CIPFA member, CIPFA's Standard of Professional Practice on Treasury Management.
- Overview and Scrutiny Committee to be responsible for ensuring effective scrutiny of the treasury management strategy and policies.

4. Definition of Treasury Management

4.1 Herefordshire council defines its treasury management activities as: -

'The management of the organisation'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.'

5. Policy Objectives

5.1 Herefordshire council 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 council, and any financial instruments entered into to manage these risks.

5.2 Herefordshire council 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.

6. Non-treasury investments

6.1 Herefordshire Council recognises that investment in other financial assets and property primarily for financial return, taken for non-treasury management purposes, requires careful investment management. Such activity includes loans supporting service outcomes, investments in subsidiaries and investment property portfolios.

6.2 Herefordshire Council will ensure that all investments in the capital programme will set out, where relevant, the risk appetite and policy and arrangement for non-treasury investments. The risk appetite for these activities may differ from that of treasury management.

6.3 Herefordshire Council will maintain a schedule setting out a summary of existing material investments, subsidiaries, joint ventures and liabilities including financial guarantees and the organisations risk exposure within its annual statement of accounts.