

Treasury Management Strategy Statement 2019/20

Herefordshire Council

Treasury Management Strategy 2019/20

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## Treasury Management Strategy Statement 2019/20

### 1. Introduction

- 1.1 Treasury management is the pursuit of optimum performance in the management of cash flows consistent with managing the associated risks. 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 an effective treasury management strategy.
- 1.2 This strategy has been prepared in accordance with the revised reporting due to revisions of the MHCLG Investment Guidance, the MHCLG Minimum Revenue Provision (MRP) Guidance, the CIPFA Prudential Code and the CIPFA Treasury Management Code. The primary reporting changes include the introduction of a capital strategy, to provide a longer-term focus to the capital plans, and greater reporting requirements surrounding any commercial activity undertaken under the Localism Act 2011. The capital strategy is being reported separately.
- 1.3 The purpose of this Treasury Management Strategy (TMS) is to approve:
- Treasury Management Strategy for 2019/20
  - Borrowing – Section 5
  - Investments – Section 6
  - Minimum Revenue Payment (MRP) Statement – Section 7
  - Prudential Indicators – Annex C

### 2. Summary of Strategy for 2019/20

#### Borrowing

- 2.1 Borrowing is driven by the requirements of the approved capital investment budget. The forecast capital investment budget for 2019/20 indicates £69.3m of capital spend requiring financing from prudential borrowing. As long term borrowing rates are expected to be higher than investment rates, actual borrowings will be deferred by utilising cash balances and short term borrowing if required. Long term interest rate forecasts will be constantly monitored to ensure debt need is secured at the best opportunity. If less capital spend is incurred than forecast then the need to borrow will be reduced.
- 2.2 Using current forecasts during 2019/20 the councils underlying need to borrow is expected to increase by £72.2m, as shown in the table below.

	<b>£m excluding PFIs</b>
<b>Estimated council borrowing as at 31<sup>st</sup> March 2019</b>	<b>165.3</b>

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Capital spend financed by prudential borrowing	69.3
Net change in internal borrowing	9.9
Less minimum revenue provision	(7.0)
<b>Estimated council borrowing as at 31<sup>st</sup> March 2020</b>	<b>237.5</b>
<b><i>Increase in estimated council borrowing</i></b>	<b>72.2</b>

- 2.3 Short-term borrowing rates are currently, at 1.15%, significantly lower than longer-term borrowing rates (Annex D) and using the long-term analysis, comparing short-term finance with a long-term loan, utilising short term borrowing is shown to be the most cost effective approach. Savings in the early years are currently outweighing additional amounts payable that may fall due in later years. Therefore the council is proposing to continue with its current policy of using short term borrowing to finance the 2019/20 borrowing requirement.
- 2.4 The borrowing budget for 2019/20 includes provision to pay short-term interest costs of up to £0.6m. The budget also includes the interest cost on existing fixed long term borrowing at £5.4m.
- 2.5 This strategy approves a total variable loan stock holding of up to 50% of total loans. By restricting variable loan stock to a total of 50% of loans held this minimises the cost risk of interest rate increases, fixed rate loans can be secured quickly if interest rates appear to be increasing.
- 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 (CNAV (Constant Net Asset Value), LVNAV (Low Volatility Net Asset Value), or VNAV (Variable Net Asset Value));
  - Maintain counterparty limits with the banks and building societies at prudent levels;
  - Consider other creditworthy investments to increase diversification.

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- 2.8 Where non treasury investments are considered, a separate report will be presented for approval with any changes that may be required to Prudential Indicators incorporated with an updated TMS if necessary.

### 3. Economic Background and Interest Rate Forecast

#### Economic background

- 3.1 **UK** the Monetary Policy Committee, (MPC), unanimously (9-0) voted to increase the Bank Rate on 2<sup>nd</sup> August from 0.5% to 0.75%. Although growth looks as if it will only be modest overall at around 1.5% in 2018, the Bank of England's August Quarterly Inflation Report forecast that growth will pick up to 1.8% in 2019, albeit there were several caveats – mainly related to whether or not the UK achieves an orderly withdrawal from the European Union in March 2019.
- 3.2 The Consumer Price Index (CPI) measure of inflation was 2.4% in September and is expected to fall back to the 2% inflation target over the next two years. The MPC has indicated that the Bank Rate would need to be in the region of 1.5% by March 2021 for inflation to stay on track. Financial markets are currently pricing in the next increase in the Bank Rate for the second half of 2019.
- 3.3 Unemployment has continued at a 43 year low of 4% on the Independent Labour Organisation measure. Wage inflation picked up to 3.1% (3 month average regular pay, excluding bonuses). This meant that in real terms (i.e. wage rates higher than CPI inflation), earnings grew by about 0.4%.
- 3.4 **Euro Zone.** Quarterly GDP growth in the euro area averaged 0.4% during the first half of 2018. That was lower than anticipated and lower than in 2017, when growth averaged 0.7%. That slowdown probably partly reflected temporary factors, including adverse weather in some northern European countries in Q1, particularly Germany and France.
- 3.5 Underlying demand growth in the Euro area appears to have remained relatively robust. Quarterly consumption growth was 0.5% in Q1, a little stronger than 2017 rates, while both consumer and business confidence remained strong.
- 3.6 The unemployment rate, at 8.3% in June, is above its estimated equilibrium rate — the rate consistent with stable wage pressures.
- 3.7 The European Central Bank (ECB) made no changes to its policy rates in June or July, and provided guidance in June that rates were expected to remain at present levels at least through the summer of 2019. The ECB also announced an extension to its asset purchase programme to December 2018, at a slower rate of €15 billion per month, reduced from €30 billion currently, and anticipated an end to net purchases after that date, subject to incoming data.

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- 3.8 **USA** activity in the US — the UK's second largest trading partner — rebounded strongly from a dip in growth in Q1, expanding by 1% in Q2. GDP growth is expected to fall back in Q3, but to remain robust at around 0.75%. Activity will be supported thereafter by fiscal policy, following the personal and corporate tax cuts announced in December 2017, as well as the Bipartisan Budget Act of 2018, which lifted discretionary spending caps by around US\$300 billion over 2018 and 2019, equivalent to around 1.5% of GDP.
- 3.9 The economy in the US is growing at approximately three times the rate of that in the UK. It currently has the lowest unemployment rates in almost 50 years.
- 3.10 There are risks coming through though including higher tariffs that have been implemented or proposed on US trading partners and associated reciprocal measures.
- 3.11 The Federal Open Market Committee (FOMC) has continued to tighten policy, raising the target range for the federal funds rate to between 1.75% and 2% in June. The median projection of FOMC members for the federal funds rate at end 2018 also rose from 2.1% to 2.4%, implying two further 25 basis point increases in 2018, with a further three projected in 2019.

**Interest rate forecast**

- 3.12 Investment returns are likely to remain low during 2019/20 but to be on a gently rising trend over the next few years based on an assumption of an agreement being reached on Brexit between the UK and the EU.
- 3.13 Borrowing interest rates are slowly increasing, most recently as a result of the August MPC meeting where the Bank Rate was increased by 0.25% to 0.75%. The policy of avoiding new borrowing by minimising investment cash balances has proved efficient and will continue to be carefully reviewed to minimise the risk of incurring higher borrowing costs in the future.
- 3.14 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.
- 3.15 A more detailed interest rate forecast provided by the Link Asset Services is attached at Annex 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.

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- 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 Annex C. The movement in actual external debt and usable reserves (which have a direct bearing on requiring to borrow) combine to identify the council's borrowing requirement and potential investment strategy in the current and future years. The table below summarises the current forecast:-

	<b>31.03.19 Estimate £000</b>	<b>31.03.20 Estimate £000</b>	<b>31.03.21 Estimate £000</b>	<b>31.03.22 Estimate £000</b>
<b>Forecast Capital Finance Requirement (CFR)</b>	317,813	378,018	388,889	382,734
Less: Expected Useable Capital Receipts Reserve	(35,200)	(23,300)	(23,300)	(23,300)
<b>CFR post capital receipts</b>	<b>282,613</b>	<b>354,718</b>	<b>365,589</b>	<b>359,434</b>
Less: PFI and other long term commitments	(53,226)	(51,097)	(49,053)	(47,091)
<b>CFR excluding other long-term liabilities (PFIs)</b>	<b>229,387</b>	<b>303,621</b>	<b>316,536</b>	<b>312,343</b>
Less: Existing fixed long term borrowing (a)	(137,517)	(130,282)	(126,798)	(124,427)
<b>Maximum new borrowing requirement</b>	<b>91,870</b>	<b>173,339</b>	<b>189,738</b>	<b>187,916</b>
Less: Internal borrowing from reserves	(64,100)	(66,100)	(62,700)	(62,700)

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<b>Net new borrowing requirement (b)</b>	<b>27,770</b>	<b>107,239</b>	<b>127,038</b>	<b>125,216</b>
<b>Total Council Borrowing (a plus b)</b>	<b>165,287</b>	<b>237,521</b>	<b>253,836</b>	<b>249,643</b>

4.6 The above table shows the council's borrowing requirement due to capital expenditure and the refinancing of principal repaid on existing long-term debt.

## 5. Borrowing Strategy

5.1 At 30 September 2018 the council held £140.3m of long-term fixed rate loans as shown in Annex A. Current capital expenditure forecasts suggest that this will increase before the end of the financial year, if spend slips then the need to borrow will be deferred.

### 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.

### 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 and reduce its overall credit risk by tailoring the timing of borrowing to minimise cash 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 council's 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 2019/20 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:

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- 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 arrangements

### 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 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 maintains a cash flow balance 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 MHCLG Guidance require the Authority to invest its funds prudently, and to have regard to the security and liquidity of its investments



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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 reduce the amounts invested with banks and building societies. For 2019/20 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 ratings 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:

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## AAA

- Australia
- Canada
- Denmark
- Germany
- Luxembourg
- Netherlands
- Norway
- Singapore
- Sweden
- Switzerland

## AA+

- Finland
- U.S.A.

## AA

- Abu Dhabi (UAE)
- France
- Hong Kong
- UK

## AA-

- Belgium
- Qatar

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.

**Table 2: Approved Investment Counterparties and Limits**

		<b>Colour coding or long term rating</b>	<b>£ limit</b>	<b>Time limit</b>
Banks and Building Societies	Term deposits, CDs or corporate bonds	Yellow	5m	5 years
		Purple	5m	2 years
		Orange	5m	1 year
		Blue	5m	1 year
		Red	5m	6 months
		Green	5m	100 days

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		No colour	nil	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
<b>Other investments:</b>				
Top five UK Building Society		£5m per fund (up to six months' duration)		
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 MHCLG 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".

6.9 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

6.10 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

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on high credit quality. Limits on non-specified investments are shown in table 3 below.

<b>Table 3: Non-Specified Investment Limits</b>	<b>Cash limit</b>
Total long-term investments	£5.0m
Total investments with unrecognised credit ratings	£5.0m
Total non-specified investments	£10.0m

## 7. Annual Minimum Revenue Provision Statement 2019/20

- 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 Ministry of Housing, Communities and Local Government's Guidance on Minimum Revenue Provision (the MHCLG Guidance) most recently issued in 2018. The broad aim of the Guidance is to ensure that debt is repaid over a period that is reasonably commensurate with that over which the capital expenditure provides benefits. In line with the Guidance, the policy for the 2019/20 calculation of MRP is as follows:

	<b>Indicative 2019/20 MRP charge £000</b>
Supported borrowing	1,316
Prudential borrowing	6,160
Overprovision adjustment	(477)
Finance leases and private finance initiatives	2,129
<b>TOTAL</b>	<b>9,128</b>

MRP on supported borrowing is written down on an annuity basis with an annuity rate of 2%.

MRP on unsupported borrowing incurred before 1 April 2008 will be written down on a straight line basis over the asset life.

MRP on unsupported borrowing from 1 April 2008 onwards is written down on an annuity basis with an annuity rate of 3%.

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.

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## Annex A

## EXISTING BORROWING AND INVESTMENTS

The overall treasury management portfolio as at 31 March 2018 and for the position as at 30 September 2018 are shown below for both borrowing and investments.

## TREASURY PORTFOLIO

	actual	actual	As at	As at
Treasury Investments	31.3.18	31.3.18	30.09.18	30.09.18
	£000	%	£000	%
Banks - rated	4,740	34%	5,000	14%
building societies - rated	0	0%	0	0%
local authorities	5,000	35%	20,000	56%
DMADF (H.M. Treasury)	0	0%	0	0%
money market funds	4,380	31%	10,850	30%
certificates of deposit	0	0%	0	0%
<b>Total managed in house</b>	<b>14,120</b>	<b>100%</b>	<b>35,850</b>	<b>100%</b>
bond funds	0	0%	0	0%
property funds	0	0%	0	0%
<b>Total managed externally</b>	<b>0</b>	<b>0%</b>	<b>0</b>	<b>0%</b>
<b>Total treasury investments</b>	<b>14,120</b>	<b>100%</b>	<b>35,850</b>	<b>100%</b>
Treasury external borrowing				
local authorities	5,000	3%	0	0%
PWLB	131,054	89%	128,266	91%
LOBOs	12,000	8%	12,000	9%
<b>Total external borrowing</b>	<b>148,054</b>	<b>100%</b>	<b>140,266</b>	<b>100%</b>
<b>Net treasury investments / (borrowing)</b>	<b>(133,934)</b>	<b>0</b>	<b>(104,416)</b>	<b>0</b>

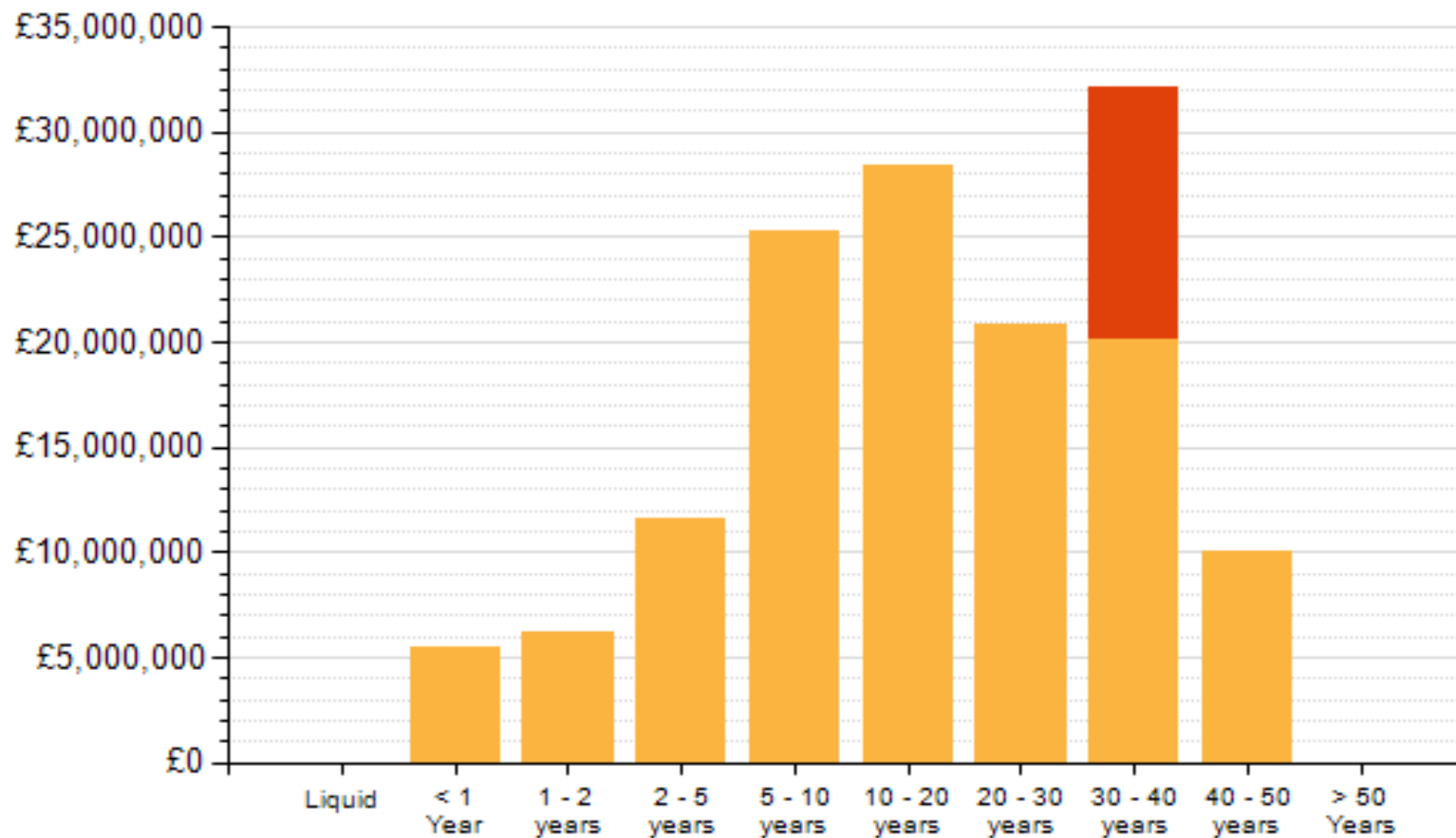
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Annex B

BORROWING MATURITY PROFILE



Loans Maturities by Type



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## Annex C

## 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 for the next three years.

## 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	2018/19 £000	2019/20 Estimate £000	2020/21 Estimate £000	2021/22 Estimate £000	Total £000
Existing approvals	68,404	118,428	44,673	3,415	234,920
Expected additional schemes	-	11,697	10,106	8,106	29,909
<b>Total expenditure</b>	<b>68,404</b>	<b>130,125</b>	<b>54,779</b>	<b>11,521</b>	<b>264,829</b>
<b>Funding</b>					
Capital receipts	14,091	11,944	-	-	26,035
Grants & contributions	41,171	48,848	32,960	5,613	128,592
Prudential borrowing	13,142	69,333	21,819	5,908	110,202
<b>Total</b>	<b>68,404</b>	<b>130,125</b>	<b>54,779</b>	<b>11,521</b>	<b>264,829</b>

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#### 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:

Capital Financing Requirement (CFR)	2019/20 Estimate £000	2020/21 Estimate £000	2021/22 Estimate £000
Total forecast CFR	378,018	388,889	382,734

#### 4. 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 the limit beyond which external debt is not normally expected to exceed. In most cases, this would be a similar figure to the CFR, but may be lower or higher depending on the levels of actual debt and the ability to fund under-borrowing by other cash resources.

Operational Boundary	2019/20 Estimate £000	2020/21 Estimate £000	2021/22 Estimate £000
Operational Boundary for Borrowing	330,000	340,000	340,000
Operational Boundary for other Long-Term Liabilities	60,000	60,000	60,000
<b>Operational Boundary for External Debt</b>	<b>390,000</b>	<b>400,000</b>	<b>400,000</b>



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### 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.

Authorised Limit	2019/20 Estimate £000	2020/21 Estimate £000	2021/22 Estimate £000
Authorised Limit for Borrowing	350,000	350,000	350,000
Authorised Limit for other Long-Term Liabilities	70,000	70,000	70,000
<b>Authorised Limit for External Debt</b>	<b>420,000</b>	<b>420,000</b>	<b>420,000</b>

### 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	2019/20 Estimate £'000	2020/21 Estimate £'000	2021/22 Estimate £'000
Net Revenue Stream	150,987	156,985	163,224
Financing Costs	12,999	14,872	16,177
<b>Percentage</b>	<b>8.6%</b>	<b>9.5%</b>	<b>9.9%</b>

- 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.

### 8 Adoption of the CIPFA Treasury Management Code

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

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8.2 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 Annex E.

#### 9. Upper Limits for Fixed Interest Rate Exposure and Variable Interest Rate Exposure

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

	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
<b>Upper Limit for Fixed Interest Rate Exposure</b>	<b>100%</b>	100%	100%
<b>Upper Limit for Variable Interest Rate Exposure</b>	<b>50%</b>	50%	50%

#### 10. Maturity Structure of Fixed Rate Borrowing

10.1 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.

10.2 The maturity of borrowing (as shown in Annex B) 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 31/03/19	Lower Limit for 2019/20	Upper Limit for 2019/20
Under 12 months	5%	0%	35%
12 months and within 24 months	3%	0%	30%
24 months and within 5 years	9%	0%	25%
5 years and within 10 years	18%	0%	25%
10 years and within 20 years	20%	0%	40%
20 years and within 30 years	15%	0%	40%

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30 years and within 40 years	23%	0%	40%
40 years and within 50 years	7%	0%	40%
<b>Total</b>	<b>100%</b>		

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

- 11.1 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.

<b>Upper Limit for total principal sums invested over 364 days</b>	<b>2019/20 Estimate</b>	<b>2020/21 Estimate</b>	<b>2021/22 Estimate</b>
	<b>£m</b>	<b>£m</b>	<b>£m</b>
<b>Authorised counterparties</b>	<b>5</b>	<b>5</b>	<b>5</b>

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## Annex D

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

	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22
<b>Bank Base Rate (%)</b>	0.75	1.00	1.00	1.00	1.00	1.25	1.25	1.50	1.50	1.50	1.75	1.75	2.00
<b>PWLB Rates (%):</b>													
<b>5 years</b>	2.10	2.20	2.20	2.30	2.30	2.40	2.50	2.50	2.60	2.60	2.70	2.70	2.80
<b>10 years</b>	2.50	2.60	2.70	2.70	2.80	2.90	2.90	3.00	3.10	3.10	3.20	3.20	3.20
<b>25 years</b>	3.00	3.00	3.10	3.20	3.20	3.30	3.40	3.50	3.50	3.60	3.60	3.60	3.70
<b>50 years</b>	2.80	2.80	2.90	3.00	3.00	3.10	3.20	3.30	3.30	3.40	3.40	3.40	3.50
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 June 2019 at which point small stepped increases are anticipated. Capital Economics forecast that interest rates will increase more rapidly.

**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 0.75% for the first quarter of 2019/20 possibly increasing to 1.00% for the remainder 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.

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- The investment budget is based on the majority of funds being held in instant access accounts generating low returns, currently budgeted at 0.5%.
- 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 borrowing rates.

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## Annex E

**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

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year, a mid-year review and an annual report after its close.

- 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.