

Herefordshire Council

Treasury Management Strategy
2020/21 – 2023/24

Treasury Management Strategy 2020-24

Herefordshire Council

Treasury Management Strategy 2020/21-2023/24

Contents

1. Introduction
2. Summary of Strategy for 2020/21
3. Economic Background and Interest Rate Forecast
4. Capital Financing Requirement
5. Borrowing Strategy
6. Annual Investment Strategy
7. Annual Minimum Revenue Provision Statement 2020/21

Annex

- a. Existing Borrowing and Investments
- b. Borrowing Maturity Profile
- c. Prudential and Treasury Indicators for the next four years
- d. Outlook for Interest Rates
- e. Treasury Management Policy Statement

Treasury Management Strategy 2020-24

1. Introduction

- 1.1 Treasury management is the management of the council'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. 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 MHCLG Investment Guidance, the MHCLG Minimum Revenue Provision (MRP) Guidance, the CIPFA Prudential Code and the CIPFA Treasury Management Code and should be considered alongside the council's capital strategy (reported separately).
- 1.3 The purpose of this Treasury Management Strategy (TMS) is to approve:
- Treasury Management Strategy for 2020/21-2023/24
 - Borrowing Strategy – Section 5
 - Annual Investment Strategy – Section 6
 - Minimum Revenue Payment (MRP) Policy Statement – Section 7
 - Prudential Treasury Indicators – Annex C
- 1.4 In addition to the TMS, the council maintains treasury management practices that outline how the council's strategic policy objectives for treasury management will be achieved and are supported by schedules that describe the specific procedures to be used by staff involved in treasury management activities. The operational practices are maintained by the corporate finance team and approved by the chief finance officer.

2. Summary of Strategy for 2020/21

- 2.1 The financial market continues to offer low levels of interest rate cost of borrowing and even lower interest rate returns on investments therefore the council continues to aim to minimise the cash balances it maintains. If the UK were to enter a recession there is a small chance that the Bank of England could set its bank base rate at or below zero, which could lead to negative interest rates on low risk, short term investments. This situation has been present in other countries. This risk can be partially mitigated by aiming to invest longer term and diversifying the investment base. Due regard to IFRS9 will be made before diversifying investments into investments like pooled investment funds. Currently a five year statutory accounting override exists (expiring 2023/24) however going forward fair value movements in these investment types will be chargeable to the revenue budget.

Treasury Management Strategy 2020-24

Borrowing

- 2.2 Borrowing is driven by the requirements of the approved capital investment budget. The forecast capital investment budget for 2020/21 indicates £54.8m 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 is secured at the best opportunity. If less capital spend is incurred than forecast then the need to borrow will be reduced.
- 2.2 From the 9th October 2019 central government announced a 1% increase in the public works loan board (PWLB) interest rate. The PWLB loan interest rate is linked to benchmark gilt rates and due to these being historically low the Treasury announced an immediate increase in the margin of 1%. PWLB is the usual route of obtaining loan finance for councils including Herefordshire Council. The forecast interest cost of new borrowing has therefore been increased to reflect this additional cost burden.
- 2.3 Using current forecasts during 2020/21 the councils underlying need to borrow is expected to increase by £55.9m, as shown in the table below.

	£m excluding PFIs
Estimated council borrowing as at 31st March 2020	163.6
Capital spend financed by prudential borrowing	54.8
Net change in internal borrowing	8.7
Less minimum revenue provision	(7.6)
Estimated council borrowing as at 31st March 2021	219.5
<i>Increase in estimated council borrowing</i>	55.9

- 2.3 Short-term borrowing rates are currently, at 2%, 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 2020/21 borrowing requirement.

Treasury Management Strategy 2020-24

- 2.4 The borrowing budget for 2020/21 includes provision to pay short-term interest costs and the interest cost on existing fixed long term borrowing, a total budget of £6.2m.
- 2.5 The council's strategy is to cap the total short term loan stock holding at a threshold of a maximum of 50% of total loans. By restricting short term loans to a total of 50% of loans required the risk on interest rate exposure is minimised. Fixed rate loans can be secured quickly if this is decided the correct action to follow in consideration of all known factors at that time (including the councils cashflow and interest rate forecasts). Currently the council holds no short term loans, all loans are currently secured at a fixed interest rate and over a long term.
- 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 local consideration of interest rate forecasts.

Investments

- 2.7 When the council holds surplus funds (income received in advance of expenditure) the Code and Guidance requires councils to invest these funds prudently and to have regard to the security and liquidity of its investments before seeking the highest rate of return. The council tends to invest in banks, building societies, other local authorities and money market funds. The council continually assesses the various investment risks in conjunction with the support of its treasury advisors, Link Asset Services.

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 (LVNAV (Low Volatility Net Asset Value));
 - Maintain counterparty limits with the banks and building societies at prudent levels;
 - Consider other creditworthy investments to increase diversification.
- 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.

Treasury Management Strategy 2020-24

3. Economic Background and Interest Rate Forecast

Economic background

- 3.1 **UK** the Bank of England's Monetary Policy Committee (MPC) kept Bank Rate on hold in January 2020. Inflation is not expected to get back to c2% for a couple of years however there is the prospect of some fiscal loosening and major government expenditure announcements in the 11th March budget. The UK exited the EU on 31 January 2020, with a full exit expected on 31st December 2020, the markets and the Bank of England will be looking closely at what progress is being made in respect of future trading arrangements during 2020.
- 3.2 The Consumer Price Index (CPI) measure of inflation was 2.1% in July 2019 is likely to shift only a little upwards over the rest of 2019/20. It does not therefore pose any immediate concern to the MPC at the current time.
- 3.3 Unemployment has continued near to a 44-year low of 4% on the Independent Labour Organisation measure. Wage inflation picked up to a high point of 3.9% (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 1.8%.
- 3.4 **Euro Zone.** Growth has been slowing from +1.9% during 2018 to +0.4% q/q (+1.2% y/y) in quarter 1 and then to +0.2% q/q (+1.0% y/y) in quarter 2; there appears to be little upside potential to the growth rate in the rest of 2019. German GDP growth fell to -0.1% in quarter 2; industrial production was down 5.2% y/y in June with car production especially being hit. Germany would be particularly vulnerable to a no deal Brexit depressing exports further and if President Trump imposes, tariffs on EU produced cars. The ECB meeting in July expressed concern as to the weak outlook for growth and how low inflation was despite all the monetary stimulus the bank still has in place. The ECB is therefore expected to take action to cut its main rate of -0.4% further, but only marginally, and to look at the potential for more quantitative easing and/or other instruments of monetary policy to provide further stimulus to economic growth. On the political front, Spain and Italy are in the throes of trying to form coalition governments while the very recent results of two German state elections will put further pressure on the frail German CDU/SDP coalition government.
- 3.8 **USA** President Trump's massive easing of fiscal policy in 2018 fuelled a temporary boost in consumption in that year which generated an upturn in the rate of strong growth to 2.9% y/y. Growth in 2019 has been falling back after a strong start in quarter 1 at 3.1%, (annualised rate), to 2.0% in quarter 2. Quarter 3 is expected to fall further. The Fed finished its series of increases in rates to 2.25 – 2.50% in December 2018. In July 2019, it cut rates by 0.25% as a 'midterm adjustment' but flagged up that this was not to be seen as the start of a series of cuts to ward off a downturn in growth. Financial markets are, however, expecting another cut in September. Investor confidence has been badly rattled by the progressive ramping up of increases in tariffs President Trump has made on Chinese imports and China has responded with increases in tariffs on American imports. This trade war is seen

Treasury Management Strategy 2020-24

as depressing US, Chinese and world growth. In the EU, it is also particularly impacting Germany as exports of goods and services are equivalent to 46% of total GDP. It will also impact developing countries dependent on exporting commodities to China. The US tariff war with China continues but, more recently, a phase one deal has been agreed which gives some hope for progress in resolving this dispute.

Interest rate forecast

- 3.12 Investment returns are likely to remain low during 2020/21, the first bank rate increase is currently predicted to occur in June 2021 and then remain on a gently rising trend over the next few years.
- 3.13 Borrowing interest rates were on a downward trend during the first half of 2019/20 until the announcement of an additional 1% margin from 9th October 2019. 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 incur a revenue cost of the difference between higher borrowing costs and lower investment returns. For example borrowing could be secured at a 3% interest cost and an investment could generate a 1% return, representing a cost of carry of 2%.
- 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.
- 4.2 Capital expenditure not financed by one of the above methods will increase the capital financing requirement (CFR) of the council, representing the councils underlying borrowing requirement.
- 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 and finance leases.
- 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, at any point in time, will 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.

Treasury Management Strategy 2020-24

- 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 reserve balances (which have a direct bearing on the requirement 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:-

	31.03.20 Estimate £000	31.03.21 Estimate £000	31.03.22 Estimate £000	31.03.23 Estimate £000
Forecast Capital Finance Requirement (CFR)	331,053	380,369	390,149	388,443
Less: PFI and other long term commitments	(51,772)	(50,014)	(48,326)	(46,706)
CFR excluding other long-term liabilities (PFIs)	279,281	330,355	341,823	341,737
Less: Existing fixed long term borrowing (a)	(130,282)	(163,598)	(217,427)	(227,501)
Maximum new borrowing requirement	148,999	166,757	124,396	114,236
Less: Internal borrowing from reserves	(115,683)	(110,818)	(114,300)	(109,500)
Net new borrowing requirement (b)	33,316	55,939	10,096	4,736
Total Council Borrowing (a plus b)	163,598	219,537	227,523	232,237

- 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. CIPFA's Prudential Code for Capital Finance in Local Authorities recommends that the council's total debt should be lower than its highest forecast CFR over the next three years. The council expects to comply with this recommendation.
- 4.7 From 1 April 2020 councils will be required to comply with IFRS16 that requires lease arrangements to be disclosed as finance leases, this will have the effect of increasing the capital financing requirement. The table above exclude this impact as work continues on establishing the effect of this accounting change. Indications are that the impact will be immaterial.

Treasury Management Strategy 2020-24

5. Borrowing Strategy

- 5.1 At 30 September 2019 the council held £134.8m 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 forecasted 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 2020/21 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; therefore the risk is mitigated by restricting the exposure to this risk at 50% of the debt total.

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.

Treasury Management Strategy 2020-24

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. Annual 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 £20m 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 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.

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 limit the amounts invested with banks and building societies. For 2020/21 the council will continue to rely on Money Market Funds which are highly diversified and carry reduced credit risk.

Treasury Management Strategy 2020-24

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). The council tends to invest in UK investments; if investments are to be made overseas then approval ahead of the investment being made is required from the Chief Finance Officer. Santander UK plc (a subsidiary of Spain's Banco Santander) and Clydesdale Bank plc (a subsidiary of National Australia Bank) will be classed as UK banks due to their substantial franchises and the arms-length nature of the parent-subsidary relationship.

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. A group of banks under the same ownership will be treated as a single organisation for investment limit purposes.

		Colour coding or long term rating	£ limit	Time limit
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
		No colour	nil	Not to be used
Council's Banker (NatWest)			5m	Liquid
DMADF	DMADF account	AAA	Unlimited	6 months

Treasury Management Strategy 2020-24

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
Other investments:				
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 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	£5.0m

Treasury Management Strategy 2020-24

Total investments with unrecognised credit ratings	£5.0m
Total non-specified investments	£10.0m

7. Annual Minimum Revenue Provision Statement 2020/21

- 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 notional 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 2020/21 calculation of MRP is as follows:

	Indicative 2020/21 MRP charge £000
Supported borrowing	1,342
Prudential borrowing	6,729
Overprovision adjustment	(477)
Sub Total	7,594
Finance leases and private finance initiatives	2,058
TOTAL	9,652

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.

Treasury Management Strategy 2020-24

Annex A

EXISTING BORROWING AND INVESTMENTS

The overall treasury management portfolio as at 31 March 2019 and for the position as at 30 September 2019 are shown below for both borrowing and investments.

TREASURY PORTFOLIO

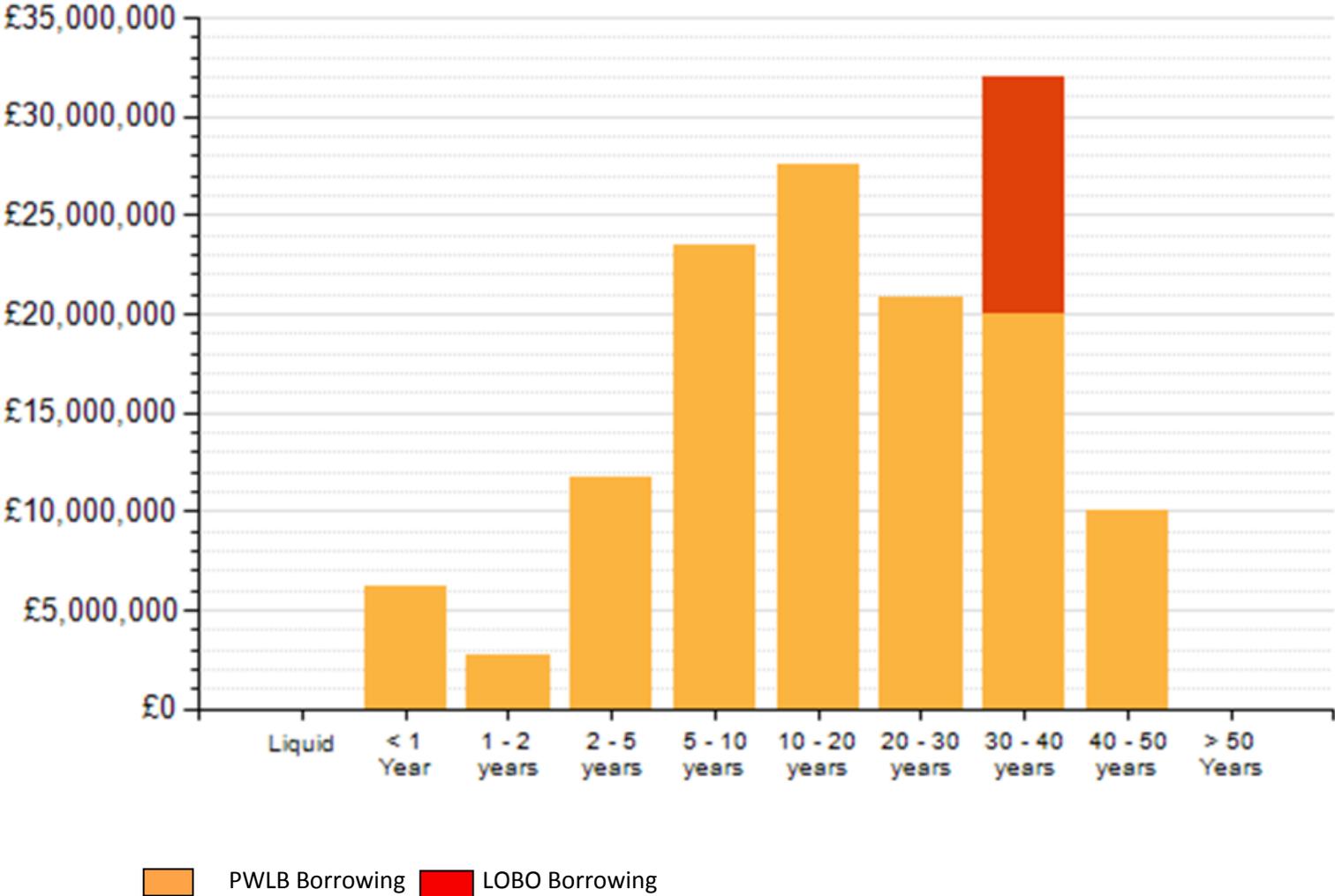
	actual	actual	current	current
Treasury Investments	31.3.19	31.3.19	30.09.19	30.09.19
	£000	%	£000	%
banks	5,000	18%	10,000	26%
building societies - unrated		0%	0	0%
building societies - rated		0%	5,000	13%
local authorities	5,000	18%	0	0%
DMADF (H.M. Treasury)		0%	0	0%
money market funds	18,140	64%	23,070	61%
certificates of deposit	0	0%	0	0%
Total managed in house	28,140	100%	38,070	100%
bond funds	0	0%	0	0%
property funds	0	0%	0	0%
Total managed externally	0	0%	0	0%
Total treasury investments	28,140	100%	38,070	100%
Treasury external borrowing				
local authorities	0	0%	0	0%
PWLB	125,517	91%	122,763	91%
LOBOs	12,000	9%	12,000	9%
Total external borrowing	137,517	100%	134,763	100%
Net treasury investments / (borrowing)	109,377	0	96,693	0

Treasury Management Strategy 2020-24

Annex B

BORROWING MATURITY PROFILE AS AT 30.11.19

Loans Maturities by Type



Treasury Management Strategy 2020-24

Annex C

PRUDENTIAL AND TREASURY INDICATORS FOR THE NEXT FOUR YEARS

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 council has fulfilled these objectives, the Prudential Code sets out the following indicators that must be set and monitored.

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	2020/21 Forecast £000	2021/22 Estimate £000	2022/23 Estimate £000	2023/24 onwards £000	Total £000
Total expenditure	121,796	47,387	29,531	21,113	219,827
Funding					
Grants, contributions and capital receipts	66,949	26,545	18,540	15,620	127,654
Prudential borrowing	54,847	20,842	10,991	5,493	92,173
Total	121,796	47,387	29,531	21,113	219,827

The table above reflects both the approved and proposed capital investment budget. Should any further borrowing be required then Council approval will be required and additional revenue resources will need to be identified to fund the additional debt repayment costs. In addition the prudential indicators would need to be revisited in accordance with the requirements of the Prudential Code to provide the assurances of affordability of the additional debt.

Treasury Management Strategy 2020-24

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.

Capital Financing Requirement (CFR)	2020/21 Estimate £000	2021/22 Estimate £000	2022/23 Estimate £000	2023/24 Estimate £000
CFR excluding PFI	330,355	341,823	341,737	339,654
PFI and finance leases*	50,014	48,326	46,706	45,150
Total forecast CFR	380,369	390,149	388,443	384,804

* this value is expected to increase following the adoption of IFRS16 from 1 April 2020 when existing lease arrangements are expected to be required to be included as finance leases in the value above

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	2020/21 Estimate £000	2021/22 Estimate £000	2022/23 Estimate £000	2023/24 Estimate £'000
Operational Boundary for Borrowing	340,000	340,000	340,000	340,000
Operational Boundary for other Long-Term Liabilities	60,000	60,000	60,000	60,000

Treasury Management Strategy 2020-24

Operational Boundary for External Debt	400,000	400,000	400,000	400,000
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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	2020/21 Estimate £000	2021/22 Estimate £000	2022/23 Estimate £000	2023/24 Estimate £000
Authorised Limit for Borrowing	350,000	350,000	350,000	350,000
Authorised Limit for other Long-Term Liabilities	70,000	70,000	70,000	70,000
Authorised Limit for External Debt	420,000	420,000	420,000	420,000

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	2020/21 Estimate £'000	2021/22 Estimate £'000	2022/23 Estimate £'000	2023/24 Estimate £'000
Net Revenue Stream	156,099	160,505	164,755	169,069
Financing Costs (excluding PFI)	13,573	17,176	18,106	19,041
Percentage	8.6%	10.7%	10.9%	11.2%

- 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.

Treasury Management Strategy 2020-24

8 Maturity Structure of Borrowing (fixed and variable)

- 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 31/03/20	Lower Limit for 2020/21	Upper Limit for 2020/21
Under 12 months	3%	0%	10%
12 months and within 24 months	2%	0%	10%
24 months and within 5 years	12%	0%	25%
5 years and within 10 years	14%	0%	35%
10 years and above	69%	0%	80%
Total	100%		

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.

Upper Limit for total principal sums invested over 364 days	2020/21 Estimate £m	2021/22 Estimate £m	2022/23 Estimate £m	2023/24 Estimate £m
Authorised counterparties	5	5	5	5

Treasury Management Strategy 2020-24

Annex D

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

	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23
Bank Base Rate (%)	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.00	1.25	1.25	1.25	1.25
PWLB Rates (%):													
5 years	2.40	2.40	2.50	2.50	2.60	2.70	2.80	2.90	2.90	3.00	3.10	3.20	3.20
10 years	2.70	2.70	2.70	2.80	2.90	3.00	3.10	3.20	3.20	3.30	3.30	3.40	3.50
25 years	3.30	3.40	3.40	3.50	3.60	3.70	3.70	3.80	3.90	4.00	4.00	4.10	4.10
50 years	3.20	3.30	3.30	3.40	3.50	3.60	3.60	3.70	3.80	3.90	3.90	4.00	4.00
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 December 2020 followed by further increase in March 2022.

Council budget:

- The proposed treasury management budget is as follows:-

	2020/21	2021/22	2022/23	2023/24
	£000	£000	£000	£000
Minimum revenue provision (excludes PFI)	7,594	9,807	10,525	11,596
Interest payable	6,179	7,569	7,781	7,645
Interest income	(200)	(200)	(200)	(200)
Totals	13,573	17,176	18,106	19,041

Treasury Management Strategy 2020-24

- 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 half of 2020/21 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 2% 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, currently budgeted at 1%.
- 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.
- Performance against budget will be reported to Cabinet in the financial performance reports.

Treasury Management Strategy 2020-24

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

Treasury Management Strategy 2020-24

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.