Herefordshire Council

Herefordshire Council

Treasury Management Strategy 2021/22 – 2024/25

Herefordshire Council

Treasury Management Strategy 2021/22-2024/25

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Treasury Management Strategy 2021-25

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 2021/22-2024/25
- 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 2021/22

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. 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 due to the potential exposure to losses against the councils general fund reserve. These must be recognised as incurred and not necessarily when the investment terms ends. 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 2021-25

Borrowing

2.2 Borrowing is driven by the requirements of the approved capital investment budget. The forecast capital investment budget for 2021/22 indicates £43.8m 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 On 26th November 2020 the HM Treasury reversed the 1% increase in the public works loan board (PWLB) interest rate that applied from October 2019. Instead there are new restrictions regarding borrowing for commercial purposes with the effect that PWLB cannot be used as the financing source for commercial investments. PWLB is the usual route of obtaining loan finance for councils including Herefordshire Council. The forecast interest cost of new borrowing has been reduced to reflect the new forecast interest rate cost on new borrowings required.

2.3 Using current forecasts during 2021/22 the councils underlying need to borrow is expected to increase by £52.4m, as shown in the table below.

	£m excluding PFIs
Estimated council borrowing as at 31st March 2021	**157.1**
Capital spend financed by prudential borrowing	43.8
Net change in internal borrowing	17.1
Less minimum revenue provision	(8.5)
Estimated council borrowing as at 31st March 2022	**209.5**
Increase in estimated council borrowing	***52.4***

2.4 The borrowing budget for 2021/22 includes provision to pay short-term interest costs and the interest cost on existing fixed long term borrowing, a total budget of £5.4m.

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.

3. Economic Background and Interest Rate Forecast

Economic background

3.1 **UK** the Bank of England's Monetary Policy Committee kept Bank Rate unchanged on 5th November. However, it revised its economic forecasts to take account of a second national lockdown from 5th November to 2nd December which is obviously going to put back economic recovery and do further damage to the economy. It therefore decided to do a further tranche of quantitative easing (QE) of £150bn, to start in January when the current programme of £300bn of QE announced in March to June, runs out. It did this so that "announcing further asset purchases now should support the economy and help to ensure the unavoidable near-term slowdown in activity was not amplified by a tightening in monetary conditions that could slow the return of inflation to the target".

3.2 Its forecasts appeared, at the time, to be rather optimistic in terms of three areas:

- The economy would recover to reach its pre-pandemic level in Q1 2022
- The Bank also expects there to be excess demand in the economy by Q4 2022.
- CPI inflation is therefore projected to be a bit above its 2% target by the start of 2023 and the "inflation risks were judged to be balanced".

3.3 Significantly, there was no mention of negative interest rates in the minutes or Monetary Policy Report, suggesting that the MPC remains some way from being persuaded of the case for such a policy, at least for the next 6 -12 months. However, rather than saying that it "stands ready to adjust monetary policy", the MPC this time said that it will take "whatever additional action was necessary to achieve its remit". The latter seems stronger and wider and may indicate the Bank's willingness to embrace new tools.

3.4 Public borrowing is now forecast by the Office for Budget Responsibility (the OBR) to reach £394bn in the current financial year, the highest ever peace time deficit and equivalent to 19% of GDP. In normal times, such an increase in total gilt issuance would lead to a rise in gilt yields, and so PWLB rates. However, the QE done by the Bank of England has depressed gilt yields to historic low levels, (as has similarly occurred with QE and debt issued in the US, the EU and Japan). This means that new UK debt being issued, and this is being done across the whole yield curve in all maturities, is locking in those historic low levels through until maturity. In addition, the UK has one of the longest average maturities for its entire debt portfolio, of any country in the world. Overall, this means that the total interest bill paid by the Government is manageable despite the huge increase in the total amount of debt. The OBR was also forecasting that the government will still be running a budget deficit of £102bn (3.9% of GDP) by 2025/26. However, initial impressions are that they have taken a pessimistic view of the impact that vaccines could make in the speed of economic recovery.

3.5 **US** the economy had been recovering quite strongly from its contraction in 2020 of 10.2% due to the pandemic with GDP only 3.5% below its pre-pandemic level and the unemployment rate dropping below 7%. However, the rise in new cases during quarter 4, to the highest level since mid-August, suggests that the US could be in the early stages of a third wave. While the first wave in March and April was concentrated in the Northeast, and the second wave in the South and West, the latest wave has been driven by a growing outbreak in the Midwest. The latest upturn poses a threat that the recovery in the economy could stall. This is the single biggest downside risk to the shorter term outlook – a more widespread and severe wave of infections over the winter months, which is compounded by the impact of the regular flu season and, as a consequence, threatens to overwhelm health care facilities. Under those circumstances, states might feel it necessary to return to more draconian lockdowns.

3.6 **EU** the economy was recovering well towards the end of Q2 and into Q3 after a sharp drop in GDP caused by the virus, (e.g. France 18.9%, Italy 17.6%). However, growth is likely to stagnate during Q4, and Q1 of 2021, as a second wave of the virus has affected many countries, and is likely to hit hardest those countries more dependent on tourism. The €750bn fiscal support package eventually agreed by the EU after prolonged disagreement between various countries, is unlikely to provide significant support, and quickly enough, to make an appreciable difference in the worst affected countries. With inflation expected to be unlikely to get much above 1% over the next two years, the ECB has been struggling to get inflation up to its 2% target. It is currently unlikely that it will cut its central rate even further into negative territory from -0.5%, although the ECB has stated that it retains this as a possible tool to use. It is therefore expected that it will have to provide more monetary policy support through more quantitative easing purchases of bonds in the absence of sufficient fiscal support from governments. The current PEPP scheme of €1,350bn of QE which started in March 2020 is providing protection to the sovereign bond yields of weaker countries like Italy. There is therefore unlikely to be a euro crisis while the ECB is able to maintain this level of support. However, the PEPP scheme is regarded as being a temporary measure during this crisis so it may need to be increased once the first PEPP runs out during early 2021. It could also decide to focus on using the Asset Purchase Programme to make more monthly purchases, rather than the PEPP scheme, and it does have other monetary policy options.

Interest rate forecast

3.7 Investment returns are likely to remain low during 2021/22 with bank rate increases not being expected in the coming years.

3.8 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 1.5% interest cost and an investment could generate a 0.4% return, representing a cost of carry of 1.1%.

3.9 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.

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:-

	31.03.21 Estimate £000	**31.03.22 Estimate £000**	**31.03.23 Estimate £000**	**31.03.24 Estimate £000**
Forecast Capital Finance Requirement (CFR)	326,801	367,534	401,654	394,434
Less: PFI and other long term commitments	(49,694)	(48,006)	(46,386)	(44,830)
CFR excluding other long-term liabilities (PFIs)	**277,107**	**319,528**	**355,268**	**349,604**
Less: Existing fixed long term borrowing (a)	(126,798)	(154,736)	(200,631)	(238,575)
Maximum new borrowing requirement	**150,309**	**164,792**	**154,637**	**111,029**
Less: Internal borrowing from reserves	(120,000)	(112,371)	(113,897)	(111,693)
Net new borrowing requirement (b)	**30,309**	**52,421**	**40,740**	**(664)**
Total Council Borrowing (a plus b)	***157,107***	***209,528***	***250,268***	***249,604***

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 2022 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.

5. Borrowing Strategy

5.1 At 30 September 2020 the council held £128.4m of long-term fixed rate loans as shown in Annex A. Current capital expenditure forecasts suggest that there will be capital spend financed by borrowing before the end of the financial year, if spend slips and / or cash balances remain high 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 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 2021/22 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.

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

<u>LOBO loans</u>

5.8 The council has two historic 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.

<u>Debt rescheduling</u>

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.

<u>Objective</u>

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 2021/22 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). 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-subsidiary 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.

Table 2: Approved Investment Counterparties and Limits

		Colour coding	**£ limit**	**Time limit**

		or long term rating		
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		10m	1 year
Money Market Funds	MMFs	AAA	10m	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

<u>Specified Investments</u>

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.

<u>Non-specified Investments</u>

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

7. Annual Minimum Revenue Provision Statement 2021/22

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 2021/22 calculation of MRP is as follows:

	Indicative 2021/22 MRP charge £000
Supported borrowing	1,369
Prudential borrowing	7,166
Sub Total	**8,535**
Finance leases and private finance initiatives	2,058
TOTAL	**10,593**

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 2021-25

Annex A

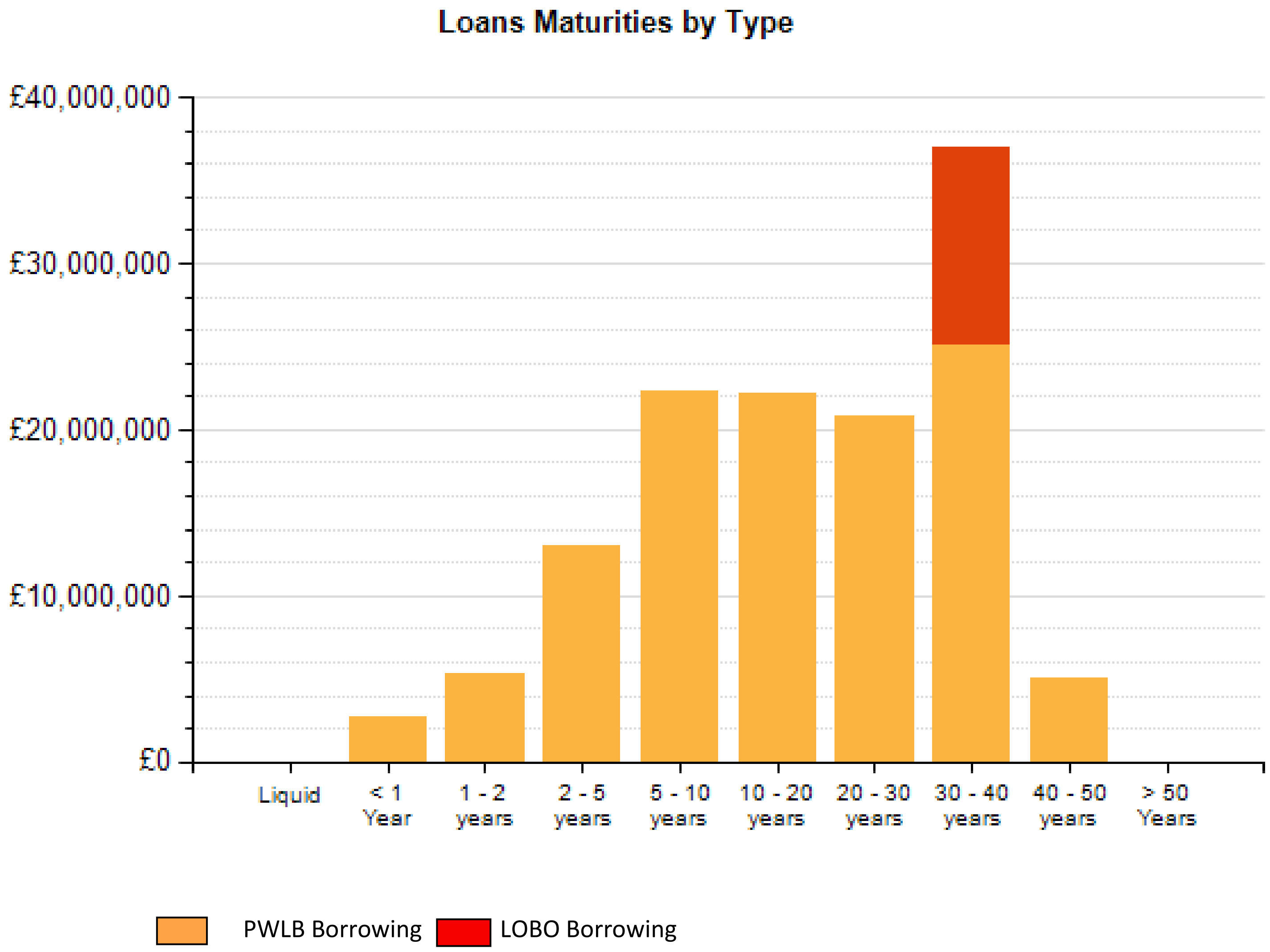
EXISTING BORROWING AND INVESTMENTS

The overall treasury management portfolio as at 31 March 2020 and for the position as at 30 September 2020 are shown below for both borrowing and investments.

TREASURY PORTFOLIO

Treasury Investments	actual **31.03.20** £000	actual **31.03.20** %	current **30.09.20** £000	current **30.09.20** %
banks	5,060	13%	13,250	20%
building societies - unrated		0%	0	0%
building societies - rated		0%	5,000	8%
local authorities	14,000	37%	15,000	23%
DMADF (H.M. Treasury)		0%	0	0%
money market funds	18,940	50%	32,810	49%
certificates of deposit	0	0%	0	0%
Total managed in house	**38,000**	**100%**	**66,060**	**100%**
bond funds	0	0%	0	0%
property funds	0	0%	0	0%
Total managed externally	**0**	**0%**	**0**	**0%**
Total treasury investments	**38,000**	**100%**	**66,060**	**100%**
Treasury external borrowing				
local authorities	0	0%	0	0%
PWLB	118,282	91%	116,398	91%
LOBOs	12,000	9%	12,000	9%
Total external borrowing	**130,282**	**100%**	**128,398**	**100%**
Net treasury investments / (borrowing)	**92,282**	**0**	**62,338**	**0**

BORROWING MATURITY PROFILE AS AT 30.11.20



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	2021/22 Forecast £000	2022/23 Estimate £000	2023/24 Estimate £000	2024/25 onwards £000	Total £000
Total expenditure	109,917	83,539	21,179	10	**214,645**
Funding					
Grants, contributions and capital receipts	66,119	44,908	15,620	0	**126,647**
Prudential borrowing	43,798	38,631	5,559	10	**87,998**
Total	**109,917**	**83,539**	**21,179**	**10**	**214,645**

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.

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)	2021/22 Estimate £000	2022/23 Estimate £000	2023/24 Estimate £000	2024/25 Estimate £000
CFR excluding PFI	319,528	355,268	349,604	347,761
PFI and finance leases*	48,006	46,386	44,830	43,337
Total forecast CFR	**367,534**	**401,654**	**394,434**	**391,098**

* *this value is expected to increase following the adoption of IFRS16 from 1 April 2022 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	2021/22 Estimate £000	2022/23 Estimate £000	2023/24 Estimate £000	2024/25 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

Operational Boundary for External Debt	**400,000**	**400,000**	**400,000**	**400,000**

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	**2021/22 Estimate £000**	**2022/23 Estimate £000**	**2023/24 Estimate £000**	**2024/25 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	**2021/22 Estimate £'000**	**2022/23 Estimate £'000**	**2023/24 Estimate £'000**
Net Revenue Stream	**160,996**	163,005	167,276
Financing Costs (excluding PFI)	**13,974**	16,118	17,753
Percentage	**8.7%**	**9.9%**	**10.6%**

7.3 The above table shows budgeted financing costs within the council's medium term financial strategy.

8 Maturity Structure of Borrowing (fixed and variable)

8.1 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.

8.2 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%**		

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

9.1 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	2021/22 Estimate £m	2022/23 Estimate £m	2023/24 Estimate £m	2024/25 Estimate £m
Authorised counterparties	**5**	**5**	**5**	**5**

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

	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23
Bank Base Rate (%)	**0.10**	**0.10**	**0.10**	**0.10**	**0.10**	**0.10**	**0.10**	**0.10**	**0.10**	**0.10**	**0.10**	**0.10**	**0.10**
PWLB Rates (%):													
5 years	**0.80**	**0.80**	**0.80**	**0.80**	**0.80**	**0.90**	**0.90**	**0.90**	**0.90**	**0.90**	**1.00**	**1.00**	**1.00**
10 years	**1.10**	**1.10**	**1.10**	**1.10**	**1.10**	**1.20**	**1.20**	**1.20**	**1.20**	**1.20**	**1.30**	**1.30**	**1.30**
25 years	**1.50**	**1.50**	**1.60**	**1.60**	**1.60**	**1.60**	**1.70**	**1.70**	**1.70**	**1.70**	**1.80**	**1.80**	**1.80**
50 years	**1.30**	**1.30**	**1.40**	**1.40**	**1.40**	**1.40**	**1.50**	**1.50**	**1.50**	**1.50**	**1.60**	**1.60**	**1.60**
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 23.

Council budget:

- The proposed treasury management budget is as follows:-

	2021/22 £000	2022/23 £000	2023/24 £000	2024/25 £000
Minimum revenue provision (excludes PFI)	8,535	10,009	11,250	12,362
Interest payable	5,439	6,109	6,503	5,988
Totals	**13,974**	**16,118**	**17,753**	**18,350**

- As can be seen from the table above, the council's treasury advisors central forecast is for the Bank Base Rate to remain at 0.10% for the foreseeable future. The council's 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.

- 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.

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 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.