

# **APPENDIX 1**

## **Treasury Management Strategy Statement 2021/22 And Prudential Indicators 2021/22 to 2023/24**

## **Treasury Management Strategy for 2021/22**

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## TREASURY MANAGEMENT STRATEGY STATEMENT

### 1 Introduction

1.1 This Treasury Management Strategy statement (TMS) has been compiled in accordance with the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice (the code) on Treasury Management (revised 2017) and additionally takes into account the following: -

- CIPFA Code of Practice on Treasury Management 2017
- CIPFA Prudential Code 2017
- CIPFA Treasury Management in the Public Services Guidance Notes 2018
- CIPFA statement 17 October 2018 on borrowing in advance of need and investments in commercial properties
- CIPFA Bulletin 02 Treasury and Capital Management Update October 2018
- Statutory investment guidance where it has been updated in 2018 (English local authorities)
- Statutory MRP guidance where it has been updated in 2018 (English local authorities)

1.2 The main objectives of the revisions to the code in 2017 were to respond to the major expansion of local authority investment activity over the past few years into the purchase of non-financial investments, particularly property. These developments had raised several concerns: -

- A local authority should define its risk appetite and its governance processes for managing risk.
- A local authority should assess the risks and rewards of significant investments over the longer term, as opposed to the usual three to five years that most local authority's financial planning has been conducted over, in order to ensure the long-term financial sustainability of the authority. (CIPFA has not defined what longer term means but it is likely to infer 20-30 years in line with the financing time horizon and the expected life of the assets, while medium term financial planning, at a higher level of detail, is probably aimed at around a 10 year time frame and to focus on affordability in particular).
- The Prudential Code has also expressed concern that; local authorities should ensure that an authority's approach to commercial activities should be proportional to its overall resources.
- A local authority should have access to the appropriate level of expertise to be able to operate safely in all areas of investment and capital expenditure, and to involve members adequately in making properly informed decisions on such investments.

- 1.3** Consequently, the Prudential Code 2017 introduced a new requirement for local authorities to produce an annual capital strategy, to deal with the above issues. This report will cover a number of key areas including strategic considerations, corporate priorities, capital investment ambition, available resources, affordability, capacity to deliver, risk appetite and risk management. It should also deal with significant commercial (focused on income generation) investments in appropriate detail so that members can properly assess the particular risks in this area. Hertsmere's Capital Strategy, which forms part of its overall Financial Strategy, was initially approved by the full Council in July 2018 (C/18/27) and is now reviewed and updated as part of the annual Capital Budget setting process for approval by the full Council.
- 1.4** In accordance with the Code the Council's TMS must be approved annually by the full Council. The Council must also receive, as a minimum, mid-year and outturn review reports.
- 1.5** Since 2016/17, the Audit Committee is the nominated body responsible for ensuring effective scrutiny of the Treasury Management Strategy and policies and receives reports as set out in paragraph 1.8 below.
- 1.6** The Financial monitoring panel also receive quarterly monitoring reports detailing projected income forecasts, creditworthiness updates and operational changes to treasury activities.
- 1.7** The aim of these reporting arrangements is to ensure that those with ultimate responsibility for the treasury management function understand fully the implications of treasury management policies and activities, and that those implementing policies and executing transactions have properly fulfilled their responsibilities with regard to delegation and reporting.
- 1.8** This Council has adopted the following reporting arrangements in accordance with the requirements of the revised Code:

Report	Committee	Frequency
Treasury Management Strategy (TMS)	Audit Committee - Scrutiny	Annually before the start of the financial year
	Full Council - Approval	Annually before the start of the financial year
Treasury Management Mid-year review	Audit Committee - Scrutiny	Annually at next available Audit Committee following 30 September
	Full Council – To Note	Annually with TMS
Annual Treasury Outturn Review	Audit Committee - Scrutiny	Annually by the 30 September after each year end
	Full Council – To Note	Annually with TMS
Treasury Management Monitoring Reports	Financial Monitoring Panel	Quarterly

- 1.9** The Council is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. A primary function of the treasury management operation is to ensure that this cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in low risk counterparties or instruments commensurate with the Council's low risk appetite, providing adequate liquidity initially before considering investment return.
- 1.10** Another main function of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer-term cash flow planning, to ensure that the Council can meet its capital spending obligations. This management of longer-term cash may involve arranging long or short-term loans, or using longer-term cash flow surpluses.
- 1.11** CIPFA defines treasury management as:
- “The management of the local authority'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.”*
- 1.12** This strategy includes views on interest rates and leading market forecasts provided by the Council's treasury advisor, Link Asset Service.

## **2 Training**

- 2.1** The CIPFA Code requires the Head of Finance and Business Services, as the responsible officer, to ensure that members with responsibility for treasury management receive adequate training in treasury management. This especially applies to members responsible for scrutiny. Training for members of the Audit Committee (and other interested members and officers) is being arranged in early 2021 and will be delivered by Hertsmere's treasury advisor, Link Asset Services.

### **3 Treasury Management Advisors**

- 3.1** The Council uses Link Asset Services as its external treasury management advisors. However, the Council recognises that responsibility for treasury management decisions remains with the organisation at all times and it will ensure that reliance is not unduly placed upon its external advisors.
- 3.2** The Council also recognise the value in employing external providers of treasury management services in order to acquire access to specialist skills and resources.

## **4 The Capital Prudential Indicators 2020/21 – 2023/24**

4.1 The Council's capital expenditure plans are a key driver of treasury management activity. The output of the capital expenditure plans is reflected in the prudential indicators that are designed to assist member overview and scrutiny of those plans.

### **4.2 Capital Expenditure**

4.2.1 This prudential indicator is a summary of the Council's capital expenditure plans as set out in the draft Capital Programme 2020/21 to 2023/24 (report ref EX/21/02)

**Table 1 - Capital Expenditure**

£'000	2020/21	2021/22	2022/23	2023/24	Total Budget 2020/21- 2023/24
	Revised Budget	Estimate	Estimate	Estimate	
Asset Management	2,443	19,065	216	-	21,724
Development Company	303	-	-	-	303
Planning & Economic Development	347	471	-	-	818
Environmental Health	1,332	750	750	750	3,582
Housing & Partnerships	-	-	-	-	-
Street Scene Services	142	1,425	-	-	1,567
Finance And Business Services	203	-	-	-	203
Human Resources & Customer Services	110	-	-	-	110
<b>Total</b>	<b>4,880</b>	<b>21,711</b>	<b>966</b>	<b>750</b>	<b>28,307</b>
<b>Financed by:</b>					
Capital Receipts	1,357	2,364	85	-	3,806
Disabled Facilities Grant	1,332	691	691	691	3,405
Earmarked Reserves	704	6,721	10	-	7,435
Housing Enabling Fund	183	179	-	-	362
Innovation and Investment Fund	500	45	-	-	545
Revenue Contribution	-	59	59	59	177
Loan	-	-	-	-	-
Grants	255	5,745	-	-	6,000
CIL / S106	549	5,907	121	-	6,577
<b>Net financing need for the year</b>	<b>4,880</b>	<b>21,711</b>	<b>966</b>	<b>750</b>	<b>28,307</b>



4.2.2 Table 1 above summarises how these capital expenditure plans are to be financed from capital or revenue resources with any shortfall in available resources resulting in a funding borrowing need.

4.2.3 The current programme is financed from specific capital or revenue resources, with no current requirement for borrowing.

4.2.4 With a number of large capital projects approved such as the Elstree Studios New Sound Stages with a total capital budget of £12m and will be partly funded from the Hertfordshire Local Enterprise Partnership (LEP). There will also be future housing investment through Hertsmere Developments Limited, which could mean the council might be required to externally borrow to fund the overall capital programme.

### 4.3 The Council's borrowing need (The Capital Financing Requirement)

4.3.1 The second prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR is quite simply the total outstanding capital expenditure that has not yet been funded from either revenue or capital resources. It is essentially a measure of the Council's underlying borrowing need. Any capital expenditure that is not immediately funded will increase the CFR.

4.3.2 The CFR cannot increase indefinitely as the Council is required to set aside an amount each year from revenue to finance historical capital expenditure that was not financed in the year it was incurred. This minimum revenue provision (MRP) is a statutory annual revenue charge which broadly reduces the borrowing need in line with each assets expected useful life.

4.3.3 **Table 2 - The Council was asked to approve the CFR projections below:**

<b>CFR projections £000's</b>	<b>2019/20 Actual</b>	<b>2020/21 Est.</b>	<b>2021/22 Est.</b>	<b>2022/23 Est.</b>	<b>2023/24 Est.</b>
Previous Year CFR B/Fwd	9,398	10,813	10,571	16,329	15,433
Net financing requirement / (repayment) for the year	1,657	-	6,000	(414)	(433)
Less: Minimum revenue provision (MRP)	(242)	(242)	(242)	(482)	(482)
<b>Total CFR</b>	<b>10,813</b>	<b>10,571</b>	<b>16,329</b>	<b>15,433</b>	<b>14,518</b>

**N.B.:** the CFR reflects the current capital spending and financing requirements as set out in the draft Capital Programme 2020/21 to 2023/24. Any other capital investment such as in Hertsmere Developments Limited may affect the CFR.

### 4.4 Adjustment A

4.4.1 The CFR includes an element known as "Adjustment A", which dates back to a change in accounting practice in 2007 and represents unfunded capital spend as at that date which could not be classified against individual Council assets.

For Hertsmere the "Adjustment A" relates to the Council's Leisure Centres now managed under full repairing leases by InspireAll (previously known as Hertsmere Leisure Trust) and Family Support Services Ltd. Historically the CFR figure was calculated less the "adjustment A", as allowed under Capital Accounting guidance.

- 4.4.2 This position was reviewed during 2015/16 and the Adjustment A element of then £9.9m was added to the CFR which had at that time been zero. Given that Hertsmere is looking at significant capital investment in the near future, which will require some borrowing, thereby increasing the Council's CFR, also being mindful of the Prudential Code's guidance on affordability, a voluntary contribution of £4.0m was set aside to reduce the CFR to £5.9m.
- 4.4.3 In 2017/18, the Council recognised a £1.0m repayment for the Local Authority Mortgage Scheme loan, which due to a change in accounting practice increased the CFR by £1.0m.
- 4.4.4 The Council has continued to make an ongoing contribution from revenue as part of the base revenue budget and this balance has been written down through the MRP mechanism by £242k per annum and the balance as at 31 March 2020 was £5.9m.
- 4.4.5 The council's capital financing requirement increased between the 2017/18 and 2019/20 financial years to a CFR position of £10.8m at 31 March 2020. This was due to the £5m loan to InspireAll as it has been marked as being funded by internal borrowing and will be replenished as the loan is repaid.
- 4.4.6 The Council approved a £12m capital project for the development of Elstree Studios New Sound Stage development which will be match funded from the Council's financing and the Hertfordshire Local Enterprise Partnership (LEP). The LEP funding requires the project is completed by 31 March 2022 resulting in an increase in the Council's CFR by £6.0m in 2021/22. The completion of the Studios project would increase the MRP by £240k from the 2022/23 financial year. The additional MRP is included in the council's draft 2020/21 to 2024/25 medium term financial plan.
- 4.4.7 Investment in Hertsmere Developments Limited have not been included within the above projections. Once these projects have been formally agreed following initial feasibility works and included within the Capital programme then the CFR may need to increase and further MRP required as Capital reserves are likely to be insufficient to finance these projects. The revenue (MRP) implications of such projects will form part of any financial appraisal and financing decision.
- 4.4.8 It is likely that the Council will seek to fund such development from future revenue streams arising from the project.

#### **4.5 Minimum Revenue Provision (MRP) policy statement**

- 4.5.1 As referred to already, the Council is required to set aside an element of the

accumulated unfunded capital spend each year (the CFR) through a revenue charge (the minimum revenue provision - MRP), although it is also allowed to undertake additional voluntary payments if required (voluntary revenue provision - VRP).

- 4.5.2 MHCLG regulations have been issued which require the full Council to approve an MRP Statement in advance of each year. Councils are required to determine each year an amount of MRP, which they consider to be prudent. MHCLG provides statutory guidance as to how it considers this duty can be met, but the guidance is not binding if alternative arrangements result in a prudent outcome. The Council is recommended to approve the following MRP Statement.
- 4.5.3 For capital expenditure incurred before 1 April 2008 or which in the future will be Supported Capital Expenditure, the MRP policy will be:
- **Option 1 – Regulatory Method** - MRP will follow the existing practice outlined in former CLG regulations (i.e. CFR is calculated after Adjustment A) However as detailed in paragraph 4.4.2 the council set aside a voluntary MRP adjustment of c.£4.0m for 2015/16. The remaining CFR balance of then £5.9m will be written down through an annual MRP from 2016/17 onwards.
- 4.5.4 From 1 April 2008 for all unsupported borrowing the MRP policy will be:
- **Option 3 - Asset life method** – MRP will be based on the estimated life of the assets, in accordance with the proposed regulations (this option must be applied for any expenditure capitalised under a Capitalisation Direction).
- 4.5.5 These options provide for a reduction in the borrowing need over approximately the asset's life.
- 4.5.6 The Council would not be required to make an MRP contribution until the financial year following completion of development.
- 4.5.7 **MRP Overpayments** - A change introduced by the revised MHCLG MRP Guidance was the allowance that any charges made over the statutory minimum revenue provision (MRP), voluntary revenue provision or overpayments, can, if needed, be reclaimed in later years if deemed necessary or prudent. In order for these sums to be reclaimed for use in the budget, this policy must disclose the cumulative overpayment made each year. As at 31 March 2020, the cumulative overpayment made is £4m, refer to paragraph 4.4.2.

## 4.6 Core funds and expected investment balances

- 4.6.1 The application of resources (capital receipts, reserves etc.) to either finance capital expenditure or other budget decisions to support the revenue budget will have an on-going impact on investments unless resources are supplemented each year from new sources (asset sales etc.). Detailed below are estimates of

the year-end balances for each resource and anticipated day to day cash flow balances.

**Table 3 – Investment Balance Forecast**

<b>Year End Resources £m</b>	<b>2020/21 Estimate</b>	<b>2021/22 Estimate</b>	<b>2022/23 Estimate</b>	<b>2023/24 Estimate</b>
Total core funds	54	50	52	54
Loans (InspireAll)	5	5	4	4
Working capital	10	10	10	10
<b>Expected investments</b>	<b>69</b>	<b>65</b>	<b>66</b>	<b>68</b>

4.6.2 The expected level of investment balances beyond the forthcoming year can be difficult to forecast as they are affected by fluctuations in working capital balance, which are only available on a temporary basis. Should the Council decide not to borrow and instead utilise internal reserves and cash balances to finance part or all of capital the level of core funds will be reduced accordingly.

#### **4.7 Affordability prudential indicators**

4.7.1 The previous sections cover the overall capital and control of borrowing prudential indicators, but within this framework prudential indicators are required to also assess the affordability of the capital investment plans. The following two indicators provide an indication of the impact of the Council's capital investment plans on its overall finances. The Council is asked to approve the following indicators:

- a. **Ratio of financing costs to net revenue stream.** This indicator identifies the trend in the cost of capital (borrowing and other long-term obligation costs net of investment income) against the net revenue stream. The estimates of financing costs include current commitments and the proposals in the budget report.
- b. **Incremental impact of capital investment decisions on council tax.** This indicator identifies the revenue costs associated with proposed changes to the three year capital programme recommended in this budget report compared to the Council's existing approved commitments and current plans. The assumptions are based on the budget, but will invariably include some estimates.

<b>Table 4 : Affordability indicators</b>	<b>2019/20 Actual</b>	<b>2020/21 Estimate</b>	<b>2020/21 Forecast</b>	<b>2021/22 Estimate</b>	<b>2022/23 Estimate</b>	<b>2023/24 Estimate</b>
<b>Ratio of financing costs to net revenue</b>	-4.86%	-2.21%	-2.94%	-1.33%	-2.86%	-3.03%
<b>Incremental impact of capital investment decisions on council tax band D -</b>	-£1.94	-£12.23	-£13.61	£4.12	-£22.86	£0.66

**N.B:** These indicators only reflect the Capital Programme 2020/21 to 2023/24 presented in the 13 January 2021 Executive meeting (EX/21/02) and does not include potential development projects yet to be approved. Currently there is a net return on investment therefore there is a positive impact on Council Tax.

## Borrowing Projections

4.7.1 The Council's anticipated Treasury position at 31 March 2021, with forward projections are summarised below.

**Table 5 - Borrowing Projections**

£m	2020/21 Original Estimate	2020/21 Revised Forecast	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate
<b>Actual gross debt at 31 March</b>	0	0	0	0	0
<b>The Capital Financing Requirement</b>	<b>9,956</b>	<b>10,571</b>	<b>16,329</b>	<b>15,433</b>	<b>14,518</b>
<b>Under / (over) borrowing</b>	<b>9,956</b>	<b>10,571</b>	<b>16,329</b>	<b>15,433</b>	<b>14,518</b>

4.8.2 As detailed in 4.3 the CFR figures have been adjusted to include the adjustment A figure.

4.8.3 The Council needs to ensure that its gross debt does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for the forthcoming financial year and the following two financial years.

4.8.4 The Head of Finance and Business Services can report that the Council complied with this prudential indicator in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans, and the proposals in the draft capital budget report EX/21/02.

## 4.9 Treasury indicators: Limits to borrowing activity

4.9.0 **The operational boundary.** This 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 schemes which are being considered.

4.9.1 **The authorised limit for external debt.** A further key prudential indicator represents a control on the maximum level of borrowing. This represents a limit beyond which external debt is prohibited, and this limit needs to be set or revised by the full Council. It reflects the level of external debt which, while not desired, could be afforded in the short term, but is not sustainable in the longer term.

4.9.2 This is the statutory limit determined under section 3 (1) of the Local Government Act 2003. The Government retains an option to control either the

total of all councils' plans, or those of a specific council, although this power has not yet been exercised.

- 4.9.3 The operational boundary. This 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.

The Council is asked to approve the following authorised limits:

<b>Table 6: External Debt Limit</b>	<b>2020/21 £m</b>	<b>2021/22 £m</b>	<b>2022/23 £m</b>	<b>2023/24 £m</b>
a) Authorised Limit to External Debt	55	55	65	75
b) Operational Boundary	50	50	60	70

**N.B.** The authorised borrowing limits reflect the approved loan facilities to InspireAll (previously known as Hertsmere Leisure Trust) (£5m) and Hertsmere Developments Limited (£50m) as well as the Council's own Capital Programme requirements.

### **Borrowing strategy**

- 4.9.4 The Council may need to borrow in order to fund potential major projects. The exact timing however will depend on project timescales, projected borrowing rates and cashflow requirements. The limits above reflect the fact that Hertsmere are looking at an internal development programme including investment in Hertsmere Developments Limited with an already agreed loan facility of £50 million. The above limits will be reviewed and increased in line with various schemes as they are approved by full Council.

### **Public Works Loan Board (PWLB)**

- 4.9.5 The PWLB have for many years provided the lowest borrowing rates available to Local Authorities. Loans are easily accessible and can generally be arranged the same day. The council has secured the "Certainty rate" which offers a 0.20% reduction to the PWLB normal rates. Whilst PWLB rates remain low careful consideration needs to be given as to the timing of any borrowing to ensure that the cost of carry does not outweigh the benefits of low rates.

- 4.9.6 Following the decision by the PWLB on 9 October 2019 to increase their margin over gilt yields by 100bps to 180 basis points on loans lent to local authorities. On 26 November 2020, the PWLB announced a 100bps reduction in new standard and certainty rate loans. There is however a restriction applied whereby the PWLB will not lend to a local authority that plans to buy investment assets primarily for yield in the capital programme. This does however exclude Housing Development.

### **UK Municipal Bonds Agency Plc**

- 4.9.7 The UK Municipal Bonds Agency Plc (The Agency) was established in 2014 as an alternative (or competitor) to the PWLB, with the purpose of reducing borrowing rates for Local Authorities. The Agency is owned by a consortium of

local authorities and the LGA and provides loans to LA's for the purpose of financing projects such as infrastructure and housing. The Agency, which raises finance by issuing municipal bonds to capital markets, claims to offer the lowest borrowing rates for Local Authorities and will be a consideration should Hertsmere decide to start borrowing again.

#### 4.10 Treasury management limits on activity

4.10.0 There are three debt related treasury activity limits. The purpose of these are to restrain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of any adverse movement in interest rates. However, if these are set to be too restrictive they can impair the opportunities to reduce costs/improve performance. The indicator limits are:

- Upper limits on variable interest rate exposure. This identifies a maximum limit for variable interest rates based upon the debt position net of investments;
- Upper limits on fixed interest rate exposure. This is similar to the previous indicator and covers a maximum limit on fixed interest rates;
- Maturity structure of borrowing. These gross limits are set to reduce the Council's exposure to large fixed rate sums falling due for refinancing, and are required for upper and lower limits. The Council is asked to approve the following treasury indicators and limits:

**Table 7 - Interest Rate Exposure Limits**

<b>Interest rate exposures</b>	<b>2020/21</b>	<b>2021/22</b>	<b>2022/23</b>
	<b>Upper</b>	<b>Upper</b>	<b>Upper</b>
<b>Borrowing - Variable</b>	30%	30%	30%
<b>Borrowing - Fixed</b>	100%	100%	100%
<b>Investments - Variable</b>	75%	75%	75%
<b>Investments - Fixed</b>	100%	100%	100%
<b>Maturity structure of fixed interest rate borrowing 2020/21</b>			
	<b>Lower</b>	<b>Upper</b>	
Under 12 months	0%	100%	
12 months to 2 years	0%	100%	
2 years to 5 years	0%	100%	
5 years to 10 years	0%	100%	
10 years and above	0%	100%	
<b>Maturity structure of variable interest rate borrowing 2020/21</b>			
	<b>Lower</b>	<b>Upper</b>	
Under 12 months	0%	100%	
12 months to 2 years	0%	100%	
2 years to 5 years	0%	100%	
5 years to 10 years	0%	100%	
10 years and above	0%	100%	

**4.11 Prospects for interest rates**

4.11.1 The Council has appointed Link Group as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. Link provided the most recent forecasts which take account of the review of PWLB margins over gilt yields on 25 November 2020, all forecasts below have been reduced by 1%. These are forecasts for certainty rates, gilt yields plus 80bps:

Link Group Interest Rate View		9.11.20											
These Link forecasts have been amended for the reduction in PWLB margins by 1.0% from 26.11.20													
	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24
BANK 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
3 month ave earnings	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
6 month ave earnings	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
12 month ave earnings	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20
5 yr PWLB	0.80	0.80	0.80	0.80	0.90	0.90	0.90	0.90	0.90	1.00	1.00	1.00	1.00
10 yr PWLB	1.10	1.10	1.10	1.10	1.20	1.20	1.20	1.20	1.20	1.30	1.30	1.30	1.30
25 yr PWLB	1.50	1.60	1.60	1.60	1.60	1.70	1.70	1.70	1.70	1.80	1.80	1.80	1.80
50 yr PWLB	1.30	1.40	1.40	1.40	1.40	1.50	1.50	1.50	1.50	1.60	1.60	1.60	1.60

4.11.2 Please note that Link have made a slight change to the interest rate forecasts table above for forecasts for 3, 6 and 12 months. Traditionally, they have used LIBID forecasts, with the rate calculated using market convention of 1/8th (0.125%) taken off the LIBOR figure. Given that all LIBOR rates up to 6m are currently running below 10bps, using that convention would give negative figures as forecasts for those periods. However, the liquidity premium that is still in evidence at the short end of the curve means that the rates actually being achieved by local authority investors are still modestly in positive territory. While there are differences between counterparty offer rates, our analysis would suggest that an average rate of around 10 bps is achievable for 3 months, 10bps for 6 months and 20 bps for 12 months.

4.11.3 During 2021, Link will be continuing to look at market developments in this area and will monitor these with a view to communicating with clients when full financial market agreement is reached on how to replace LIBOR. This is likely to be an iteration of the overnight SONIA rate and the use of compounded rates and Overnight Index Swap (OIS) rates for forecasting purposes.

4.11.4 The coronavirus outbreak has done huge economic damage to the UK and economies around the world. After the Bank of England took emergency action in March to cut Bank Rate to first 0.25%, and then to 0.10%, it left Bank Rate unchanged at its subsequent meetings to 16th December, although some forecasters had suggested that a cut into negative territory could happen. However, the Governor of the Bank of England has made it clear that he currently thinks that such a move would do more damage than good and that more quantitative easing is the favoured tool if further action becomes necessary. As shown in the forecast table above, no increase in Bank Rate is expected in the near-term as economic recovery is expected to be only gradual



and, therefore, prolonged. These forecasts were based on an assumption that a Brexit trade deal would be agreed by 31 December 2020: as this has now occurred, these forecasts do not need to be revised

4.11.5 Gilt yields and PWLB rates have been at remarkably low rates so far during 2020/21. As the interest forecast table for PWLB certainty rates above shows, there is expected to be little upward movement in PWLB rates over the next two years as it will take economies, including the UK, a prolonged period to recover all the momentum they have lost in the sharp recession caused during the coronavirus shut down period. From time to time, gilt yields, and therefore PWLB rates, can be subject to exceptional levels of volatility due to geo-political, sovereign debt crisis, emerging market developments and sharp changes in investor sentiment, (as shown on 9th November when the first results of a successful COVID-19 vaccine trial were announced). Such volatility could occur at any time during the forecast period.

Q1 2021 0.10%  
Q1 2022 0.10%  
Q1 2023 0.10%

#### **Investment and borrowing rates**

4.11.6 Investment returns are likely to remain low during 2021/22 with little increase in the following two years.

4.11.7 Borrowing interest rates fell to historically very low rates as a result of the COVID crisis and the quantitative easing operations of the Bank of England: indeed, gilt yields up to 6 years were negative during most of the first half of 20/21. The policy of avoiding new borrowing by running down spare cash balances has served local authorities well over the last few years. The unexpected increase of 100 bps in PWLB rates on top of the then current margin over gilt yields of 80 bps in October 2019, required an initial major rethink of local authority treasury management strategy and risk management. However, in March 2020, the Government started a consultation process for reviewing the margins over gilt rates for PWLB borrowing for different types of local authority capital expenditure.

4.11.8 Now that the gap between longer term borrowing rates and investment rates has materially widened, and in the long term Bank Rate is not expected to rise above 0.10%, Hertsmere will continue to use internal borrowing for now whilst monitoring rates and borrow at an appropriate time and utilise borrowing to enhance return on investment.

#### **4.12 Policy on borrowing in advance of need**

4.12.1 The Council will not borrow more than or in advance of its needs purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be within forward approved Capital Financing Requirement estimates, and will be considered carefully to ensure that value for money can

be demonstrated and that the Council can ensure the security of such funds.

#### 4.13 Treasury management: Principal sums invested and maturity

4.13.1 This indicator shows the maximum the Council expects to invest for periods longer than 364 days at any point in time and the maturity structure of those investments. It shows the Council's exposure to the possibility of loss that might arise as a result of it having to seek early repayment or redemption of principal sums invested.

**Table 8 – Investments limits beyond 1 year**

Maximum principal sums invested > 365 days			
£m	2020/21	2021/22	2022/23
Principal sums invested > 365 days	£30m	£40m	£50m

**N.B.** This reflects the approved loan facilities to InspireAll (previously known as Hertsmere Leisure Trust) (£5m) and Hertsmere Developments Limited (£50m) and excludes any decisions on non - treasury investments (inc. loans).

## 5 Current Portfolio Position

5.11 There is a favourable variance of £175k as at 31 December 2020, having achieved an investment income of £550k against a budget of £375k.

5.12 The table below sets out the Councils full year forecast.

<b>Table 9: Investment Income Forecast 2020/21</b>			
	<b>Average Investment £'000</b>	<b>Estimated Return %</b>	<b>Investment Income £'000</b>
Core Investments	63,200	0.68%	431
InspireAll Loan	4,847	4.50%	218
<b>Total / Average</b>	<b>68,044</b>	<b>0.95%</b>	<b>649</b>
<b>Budget</b>	<b>47,000</b>	<b>1.08%</b>	<b>500</b>
<b>Variance</b>	<b>21,044</b>	<b>-0.13%</b>	<b>149</b>

5.13 The forecast interest surplus has arisen in part as a result of having greater than anticipated balances available to invest throughout 2020/21, due to:

- Increased cash balances due to Covid-19 related grant income held for payment
- Prudent and conservative budgeting of investment income.
- Delays with capital spend.
- Provisions in final accounts, which have yet to materialise in cash terms.

5.14 Investment rates have fluctuated due to the uncertainty around Covid-19 and Brexit. Forward dealing and dealing at opportune times have resulted in higher investment income levels. Also there is interest from the loan to InspireAll as they have now fully drawn down the loan.

5.15 The investment portfolio, currently £68.3m (as at December 2020), is expected to reduce to £68.0m by the 31 March 2021. This is due to the cash flow requirements such as Council tax and Business rates income being paid over the first ten months of the year thus reducing investment balances in the final two months of the year.

## **6 Annual Investment Strategy**

### **6.11 Investment Policy**

6.11.1 The Council's investment policy has regard to the MHCLG's Guidance on Local Government Investments ("the Guidance") and the revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code"). The Council's investment priorities will be:

- (a) the Security of capital;
- (b) the Liquidity of its investments; and
- (c) the Yield.

6.11.2 In accordance with the above guidance from the MHCLG and CIPFA, and in order to minimise the risk to investments, the Council applies minimum acceptable credit criteria in order to generate a list of highly creditworthy counterparties which also enables diversification and thus avoidance of concentration risk. The key ratings used to monitor counterparties are the Short Term and Long Term ratings.

6.11.3 Ratings will not be the sole determinant of the quality of an institution; it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To achieve this consideration the Council will engage with its advisors to maintain a monitor on market pricing such as "credit default swaps" and overlay that information on top of the credit ratings.

6.11.4 The Council will aim to achieve the optimum return on its investments commensurate with proper levels of security and liquidity. The risk appetite of this Council is low in order to give priority to security of its investments.

6.11.5 Investments will be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months). Greater returns are usually obtainable by investing for longer periods. While most cash balances are required in order to manage the ups and downs of cash flow (amend as appropriate), where cash sums can be identified that could be invested for longer periods, the value to be obtained from longer term investments will be carefully assessed.

6.11.6 If it is thought that Bank Rate is likely to rise significantly within the time horizon being considered, then consideration will be given to keeping most investments as being short term or variable.

6.11.7 Conversely, if it is thought that Bank Rate is likely to fall within that time period, consideration will be given to locking in higher rates currently obtainable, for

longer periods.

## 6.12 Interest rate expectations

6.12.1 Bank Rate is unlikely to rise from 0.10% for a considerable period. It is very difficult to say when it may start rising so it may be best to assume that investment earnings from money market-related instruments will be sub 0.50% for the foreseeable future.

6.12.2 Bank Rate forecasts for financial year ends (March) are:

- 2020/21 0.10%
- 2021/22 0.10%
- 2022/23 0.10%
- 2023/24 0.10%

The overall balance of risks to economic growth in the UK is probably now skewed to the upside, but is subject to major uncertainty due to the virus and how quickly successful vaccines may become available and widely administered to the population. It may also be affected by what, if any, deal the UK agrees as part of Brexit.

There is relatively little UK domestic risk of increases or decreases in Bank Rate and significant changes in shorter term PWLB rates. The Bank of England has effectively ruled out the use of negative interest rates in the near term and increases in Bank Rate are likely to be some years away given the underlying economic expectations. However, it is always possible that safe haven flows, due to unexpected domestic developments and those in other major economies, or a return of investor confidence in equities, could impact gilt yields, (and so PWLB rates), in the UK.

## 6.13 Types of Investments

6.13.1 As detailed in the Treasury Code of practice "Local authorities are not constrained by law in the types of investments they may make or the investment instruments they may use". However in practice they are constrained by DCLG guidance which stresses "the prudent investment strategy of security, liquidity and yield". Investment regulations and DCLG guidance also "distinguish between 'specified' and 'non-specified' investments, the latter requiring greater scrutiny by local authorities".

6.13.2 Investment instruments identified for use in the financial year are listed below under the 'specified' and 'non-specified' investment categories.

6.13.3 **Specified Investments** – The Council will invest in "specified" investments that meet the criteria of a "specified" investment as detailed in the MHCLG guidance. These will be those that will have high security and high liquidity, denominated

in sterling and not a long term investment i.e. maturity date of no more than 12 months. The investment is not defined as capital expenditure.

The specified investments in which the Council can invest in are:

- The UK Government
- Debt Management Office Accounts
- UK Local Authorities and Parish Councils
- Term deposits with institutions or investment schemes with a credit rating that meets the criteria detailed in section 8.
- Money Market funds with AAA rating including those with a variable asset value.
- Enhanced Money market funds with AAA rating

**6.13.4 Non-specified Investments** - The Council's policy is to invest in non-specified investments, which meet all the criteria of the specified investments above, save for duration of investment. This includes but is not limited to term deposits and Certificates of deposit issued by banks or building societies and deposits beyond 12 months, which meet the criteria as set out in the investment strategy below.

**6.13.5 Unrated/lower rated Building Societies** were added to the investment strategy following approval by the Audit Committee in July 2017. Where the Building Society does not have a credit rating the Council will invest up to a maximum of £3m for max duration of 6 months providing the counterparty has an asset size of at least £3Bn. This effectively permits investments into the top 10 Building Societies by size.

**6.13.6** The Council will place deposits in accordance with the Link Asset Services' matrix recommended colour durations, and where possible spread the amounts and dates of maturing investments as evenly as possible over this period. This avoids an excess of investments maturing in any one particular time and helps towards a more stable rate of return.

## **6.14 Creditworthiness policy**

**6.14.1** This Council uses the creditworthiness service provided by its Treasury consultants; Link Asset Services. This service has been progressively enhanced over recent years and now uses a sophisticated modelling approach with credit ratings from all three rating agencies - Fitch, Moodys and Standard and Poors, forming the core element. However, it does not rely solely on the current credit ratings of counterparties but also uses the following as overlays:

- credit watches and credit outlooks from credit rating agencies
- CDS spreads to give early warning of likely changes in credit ratings

- sovereign ratings to select counterparties from only the most creditworthy countries

6.14.2 This modelling approach combines credit ratings, credit watches and credit outlooks in a weighted scoring system, which is then combined with an overlay of CDS spreads for which the end product is a series of colour code bands which indicate the relative creditworthiness of counterparties. These colour codes are also used by the Council to determine the duration for investments and are therefore referred to as durational bands. The Council is satisfied that this service gives a much improved level of security for its investments. It is also a service which the Council would not be able to replicate using in house resources.

6.14.3 The Council will therefore use counterparties within the following durational bands:

- Yellow                    5 years
- Purple                    2 years
- Blue                      1 year (applies to nationalised or semi nationalised UK Banks)
- Orange                  1 year
- Red                        6 months
- Green                    100 days
- No Colour                not to be used

6.14.4 All credit ratings will be monitored regularly. The Council is alerted to changes to ratings of all three agencies through its use of the Link Asset Service creditworthiness service.

- if a downgrade results in the counterparty/investment scheme no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn immediately. Consideration will also be given to terminating existing investments where appropriate.
- in addition to the use of Credit Ratings the Council will be advised of information in movements in Credit Default Swap against the iTraxx benchmark and other market data on a weekly basis. Extreme market movements may result in downgrade of an institution or removal from the Council's lending list.

6.14.5 Sole reliance will not be placed on the use of this external service. In addition the Council will also use market data and market information from credible sources such as financial times, information on government support for banks and the credit ratings of that government support.

## 6.15 Counterparty and Group Limits

6.15.1 As well as using the Link Asset Services' matrix, the Council will limit its exposure to any one particular Institution or group of banks, for example the

Lloyds Group and Santander Group. The Council will adopt a tiered exposure using Fitch long term (or equivalent from other agencies if Fitch does not provide) to determine the amount of funds placed with each institution. The DMO account, UK Government and Local Authorities and UK part nationalised banks will have a separate limit of £10m. Money market funds will have a credit limit of £10m per fund.

**6.16 Time and monetary limits applying to investments.**

6.16.1 The time and monetary limits for institutions on the Council's counterparty list are as follows (these will cover both specified and non-specified investments):

**Table 11 – Investment limits**

	Fitch Long term Rating (or equivalent)	Money and/or % Limit	Time Limit
Higher Quality Rated Banks	AAA AA+ AA, AA-	£10m (was £8m)	As per Link recommended duration
Medium Quality Rated Non UK Banks	A+ A	£4m	As per Link recommended duration
UK Medium Quality Rated Banks and Building Societies	A+ A	£6m	As per Link recommended duration
Part nationalised* (Currently only RBS/Natwest fall into this category)	N/A	£10m	As per Link recommended duration – Currently 1yr
Unrated Building Societies or with rating below A	Min £3B Asset Size	£3m	6 Months
Barclays Bank – Council's banker.	N/A	£5m	Daily limit
DMADF	AAA	unlimited	5yrs
Local authorities	N/A	£10m	5yrs
Money market funds	AAA	£10m (was £8m)	liquid
Enhanced Money market funds	AAA	£8m	liquid

6.16.2 It is proposed to increase the MMF & Banks to £10m due to lower interest rates



6.16.3 The council will endeavour to diversify its investment portfolio by country, group and institution. However, the Council may decide to limit counterparty diversification by investing in Countries such as the UK, Canada and Australia where there is greater understanding about economy and Government intention such as desire to support institutions from defaulting.

#### 6.17 **Sovereign limits**

6.17.1 The Council has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of AAA (or equivalent from other agencies if Fitch does not provide). This list will be added to, or deducted from; by officers should ratings change in accordance with this policy. However this does not extend to the UK which is currently rated AA+ by Fitch.

#### 6.18 **Current AAA Rated Countries by Fitch:**

- United States
- Germany
- Australia
- Switzerland
- Denmark
- Luxembourg
- Netherlands
- Norway
- Sweden
- Singapore

No more than 30% of the total portfolio is to be invested in any one country, except the UK.

#### 6.19 **Money Market Funds (MMF)**

6.19.1 Money market funds are mutual funds that invest in short-term debt instruments. They provide the benefits of pooled investment, as investors can participate in a more diverse and high-quality portfolio than they otherwise could individually. Like other mutual funds, each investor who invests in a money market fund is considered a shareholder of the investment pool, a part owner of the fund. Money market funds are actively managed within rigid and transparent guidelines to offer safety of principal, liquidity and competitive sector-related returns. The Council will invest in both Constant Net Value (C-Nav) and Variable Asset value (V-Nav) asset classes.

#### 6.20 **Enhanced Money Market Funds**

6.20.1 These are similar to Money market funds in that they use pooled cash to invest into various products and counterparties. In order to be classified and rated as a MMF the fund is required to adhere to strict rules regarding the investment types and average days until maturity of the portfolio. Enhanced funds can vary

but will generally be slightly longer dated which means they lose their MMF categorisation. The rating of the funds can vary as they are not constrained by the MMF classification however the council will only use enhanced money market funds which are AAA rated. Although these funds are highly liquid as they can be redeemed within 2-3 days they are designed to be invested for 6 to 12 months as there can be some volatility in the asset value and yield.

## **6.21 Main Bankers - Barclays**

6.21.1 Currently the council utilises Money Market funds for short-term liquidity purposes, however each payment transaction is subject to a chaps charge (bank charge). It is therefore proposed that in addition to the limits set under the main investment strategy, Barclays as our main banker will be further utilised for liquidity purposes. This will involve having balances of up to £5m held in the council business premium account through the use of the banks sweeping system and up to £10m in the instant access business premium account thus avoiding bank charges and allowing cash flow liquidity.

## **6.22 Unrated/lower rated Building Societies**

6.23 The Audit Committee were delegated authority by Council to consider the use of unrated/lower rated Building Societies following the approval of the TMS for 2017/18. The Audit committee at their meeting 31 July 2017 recommended the inclusion of unrated Building Societies within the TMS provided that they held a minimum asset size of £3Bn.

## **7 Risk Implications**

### **7.11 Monitoring**

7.11.1 On a Quarterly basis Officers will report to the Financial Monitoring Panel providing details of new investments, rate of returns and highlighting changes to sovereign rating, group limits and any other relevant treasury issues that may arise.

### **7.12 MIFID**

7.12.1 The European Union Markets in Financial Instruments Directive brought in on the 3 January 2018 means that all financial services such as banks, brokers, advisers and fund managers are required to treat Local Authorities in the same way as they would individuals and small businesses. The council has therefore elected to opt up its status to a professional client to allow it to continue to interact with these counterparties and continue to deal in the products currently utilised.

7.12.2 To this end Hertsmere is adopting the approach endorsed by the LGA by electing to return to professional status. This process involved notifying all our investment managers, advisors, brokers etc. that the Council wished to opt up to Professional Status and evidencing the Councils competence to do so.

7.12.3 Having opted in the Council are required to disclose on a yearly basis any material changes that could impact our status and it was recommended that this position be reported annually in the Treasury Management Strategy (TMS) and end of year report to Audit Committee. Hertsmere still meets all the required tests to enable it to opt up to Professional Status.

7.12.4 It should be noted that the election to Professional status has not resulted in any additional risk or change in approach as this decision was to maintain the professional status offered to the Council prior to MIFID. The Council will continue to undertake investments in accordance with the approved TMS and the Prudential Code and officers will continue to look to secure the optimum return on investments commensurate with proper levels of security and liquidity.

## **8 Treasury Management scheme of delegation**

### **(i) Full Council**

- receiving and reviewing reports on Treasury Management strategy and policy
- approval of annual strategy
- approval of/amendments to the organisation's adopted clauses, and treasury management practices
- approval of the division of responsibilities

### **(ii) Audit Committee**

- scrutiny of/amendments to the organisation's adopted clauses, and treasury management practices
- scrutiny of the division of responsibilities

### **(iii) Financial Monitoring Panel**

- Scrutiny of Treasury Management Performance
- receiving and reviewing regular monitoring reports and scrutinising on-going Treasury Management performance.

### **(iv) Managing Director**

- reviewing the treasury management policy and procedures and making recommendations to the responsible body.
- Strategic management of the Treasury management function and setting of operational limits in respect of treasury transactions.

## **The Treasury Management role of the section 151 officer**

### **The S151 (responsible) officer**

- recommending clauses, treasury management policy/practices for approval, reviewing the same regularly, and monitoring compliance
- submitting regular treasury management policy reports
- submitting budgets and budget variations
- receiving and reviewing management information reports
- reviewing the performance of the treasury management function
- ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function
- ensuring the adequacy of internal audit, and liaising with external audit
- recommending the appointment of external service providers.

## 8.1 Dealing Limits

8.1.1 All investments require approval by two designated officers before funds can be submitted. There are no dealing limits for individual posts providing the investment has met the criteria as set out in the Treasury Strategy. The following posts are permitted to deal:

- Head of Finance and Business Services – also approver
- Financial Services Manager – also approver
- Senior Business Accountant – also approver
- Treasury Manager
- Financial Accountant
- Business Accountant
- Assistant Business Accountant

8.1.2 There is segregation of anyone dealing and/or approving on each day.

8.1.3 The above officers have delegated powers conferred on them by statute or by special rules and regulations. Such officer will have levels of authorisation not commensurate with their management tier. The levels of authorisation will be based on their statutory responsibilities and not necessarily on what tier of management they may be.

8.1.4 The table below summarises the posts who can either approve, place deals or both and the treasury approval limit:

Post Title	Role	Treasury Limit
Managing Director	Approver	Unlimited
Executive Director	Approver	Unlimited
Head of Finance and Business Services (S151 Officer)	Approver / Dealer	Unlimited
Financial Services Manager (Deputy S151 Officer)	Approver / Dealer	Unlimited
Head of Legal and Democratic Services	Approver	Unlimited
Senior Business Accountant	Approver / Dealer	Unlimited
Treasury Manager	Dealer	N/A
Financial Accountant	Dealer	N/A
Business Accountant	Dealer	N/A
Assistant Business Accountant	Dealer	N/A

8.1.5 There are posts in the table above which can approve and deal. Internal controls are in place to ensure an officer can either deal or approve a treasury transaction on each day and not be able to do both.