

# **APPENDIX 1**

## **Treasury Management Strategy Statement 2022/23 And Prudential Indicators 2021/22 to 2024/25**

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## **Treasury Management Strategy for 2022/23**

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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.
- 2.2** The Council's treasury advisor, Link Asset Services, presented training for members of the Audit Committee (and other interested members and officers) in February 2021.

### **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 2021/22 – 2024/25**

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 2021/22 to 2024/25 (report ref EX/22/04)

**Table 1 - Capital Expenditure**

£'000	2021/22	2022/23	2023/24	2024/25	Total Budget 2021/22- 2024/25
	Revised Budget	Estimate	Estimate	Estimate	
Asset Management	22,923	581	10	-	23,514
Development Company	303	-	-	-	303
Planning & Economic Development	386	250	-	-	636
Environmental Health	1,540	775	750	749	3,814
Housing & Partnerships	-	-	-	-	-
Street Scene Services	2,598	1,811	939	-	5,348
Finance And Business Services	94	-	-	-	94
Human Resources & Customer Services	-	-	-	-	-
<b>Total</b>	<b>27,844</b>	<b>3,417</b>	<b>1,699</b>	<b>749</b>	<b>33,709</b>
<b>Financed by:</b>					
Capital Receipts	3,326	405	-	-	3,731
Disabled Facilities Grant	1,481	691	691	691	3,554
Earmarked Reserves	5,784	1,536	559	-	7,879
Housing Enabling Fund	179	-	-	-	179
Innovation and Investment Fund	121	-	-	-	121
Revenue Contribution	59	59	59	58	235
Borrowing	6,048	-	-	-	6,048
Grants and Other Contributions	4,971	323	380	-	5,674
CIL / S106	5,875	403	10	-	6,288
<b>Net financing need for the year</b>	<b>27,844</b>	<b>3,417</b>	<b>1,699</b>	<b>749</b>	<b>33,709</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 mainly from specific capital or revenue resources. Projects which are not funded from existing resources are currently funded within the council's existing cash balances (internal borrowing) with no current requirement for external borrowing.

4.2.4 With a number of large capital projects underway such as the Elstree Studios New Sound Stages with a total capital budget of £15.6m, partly funded from the Hertfordshire Local Enterprise Partnership (LEP) (£6m), and with planned future housing investment through Hertsmere Developments Limited, the council will now need to consider external borrowing.

### 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>2020/21 Actual</b>	<b>2021/22 Est.</b>	<b>2022/23 Est.</b>	<b>2023/24 Est.</b>	<b>2024/25 Est.</b>
Previous Year CFR B/Fwd	10,813	10,571	19,929	18,919	17,885
Net financing requirement / (repayment) for the year	-	9,600	(528)	(552)	(625)
Less: Minimum revenue provision (MRP)	(242)	(242)	(482)	(482)	(482)
<b>Total CFR</b>	<b>10,571</b>	<b>19,929</b>	<b>18,919</b>	<b>17,885</b>	<b>16,778</b>

**N.B.:** the CFR reflects the current capital spending and financing requirements as set out in the draft Capital Programme 2021/22 to 2024/25. 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.

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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 2021 was £5.7m.
- 4.4.5 The council's capital financing requirement increased between the 2017/18 and 2019/20 financial years. 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 From the adjustments explained in paragraphs 4.4.1 and 4.4.5, the CFR position as at 31 March 2021 was £10.6m.
- 4.4.7 The Council approved a £15.6m capital project for the development of Elstree Studios New Sound Stage development, which will be partly funded from the Council's financing and the Hertfordshire Local Enterprise Partnership (LEP). The LEP funding approved was £6.0m with £9.6m funded from Council resources. The Council resources will be funded by internal borrowing resulting in an increase in the Council's CFR by £9.6m 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 revenue budget from 2022/23.
- 4.4.8 Investment in Hertsmere Developments Limited has not been included within the above projections at this time. 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.
- 4.4.9 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 The Department of Levelling Up, Housing and Communities (DLUHC) 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. DLUHC 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 DLUHC 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 DLUHC 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 2021, 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>2021/22 Estimate</b>	<b>2022/23 Estimate</b>	<b>2023/24 Estimate</b>	<b>2024/25 Estimate</b>
Total core funds	62	60	58	56
Loans (InspireAll)	5	4	4	3
Working capital	10	10	10	10
<b>Expected investments</b>	<b>77</b>	<b>74</b>	<b>72</b>	<b>69</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>2020/21 Actual</b>	<b>2021/22 Estimate</b>	<b>2021/22 Forecast</b>	<b>2022/23 Estimate</b>	<b>2023/24 Estimate</b>	<b>2024/25 Estimate</b>
<b>Ratio of financing costs to net revenue</b>	-2.95%	-1.33%	-1.72%	-3.63%	-2.61%	-2.82
<b>Incremental impact of capital investment decisions on council tax band D -</b>	-£4.76	£4.12	£4.40	-£31.97	£0.58	£0.56

**N.B:** These indicators only reflect the Capital Programme 2021/22 to 2024/25 presented in the 12 January 2022 Executive meeting (EX/22/04) 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**

4.7.2 The Council's anticipated Treasury position at 31 March 2022, with forward projections are summarised below.

**Table 5 - Borrowing Projections**

<b>£m</b>	<b>2021/22 Original Estimate</b>	<b>2021/22 Revised Forecast</b>	<b>2022/23 Estimate</b>	<b>2023/24 Estimate</b>	<b>2024/25 Estimate</b>
<b>Actual gross debt at 31 March</b>	0	0	0	0	0
<b>The Capital Financing Requirement</b>	<b>16,329</b>	<b>19,929</b>	<b>18,919</b>	<b>17,885</b>	<b>16,778</b>
<b>Under / (over) borrowing</b>	<b>16,329</b>	<b>19,929</b>	<b>18,919</b>	<b>17,885</b>	<b>16,778</b>

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

4.7.4 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.

4.7.5 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/22/04.

### **4.8 Treasury indicators: Limits to borrowing activity**

4.8.1 **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.

- 4.8.2 **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.
- 4.8.3 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.
- 4.8.4 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>2021/22</b>	<b>2022/23</b>	<b>2023/24</b>	<b>2024/25</b>
	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>
a) Authorised Limit to External Debt	55	65	75	75
b) Operational Boundary	50	60	70	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**

- 4.8.5 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)**

- 4.8.6 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.
- 4.8.7 There is a restriction applied to new borrowing 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**

4.8.8 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.

#### 4.9 Treasury management limits on activity

4.9.1 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**

Interest rate exposures	2021/22	2022/23	2023/24
	<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 2021/22</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 2021/22</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%

#### 4.10 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 following forecasts on 20 December 2021.

Link Group Interest Rate View	20.12.21													
	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25
BANK RATE	0.25	0.25	0.50	0.50	0.50	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.25
3 month ave earnings	0.20	0.30	0.50	0.50	0.60	0.70	0.80	0.90	0.90	1.00	1.00	1.00	1.00	1.00
6 month ave earnings	0.40	0.50	0.60	0.60	0.70	0.80	0.90	1.00	1.00	1.10	1.10	1.10	1.10	1.10
12 month ave earnings	0.70	0.70	0.70	0.70	0.80	0.90	1.00	1.10	1.10	1.20	1.20	1.20	1.20	1.20
5 yr PWLB	1.40	1.50	1.50	1.60	1.60	1.70	1.80	1.80	1.80	1.90	1.90	1.90	2.00	2.00
10 yr PWLB	1.60	1.70	1.80	1.80	1.90	1.90	2.00	2.00	2.00	2.10	2.10	2.10	2.20	2.30
25 yr PWLB	1.80	1.90	2.00	2.10	2.10	2.20	2.20	2.20	2.30	2.30	2.40	2.40	2.50	2.50
50 yr PWLB	1.50	1.70	1.80	1.90	1.90	2.00	2.00	2.00	2.10	2.10	2.20	2.20	2.30	2.30

4.11.2 Link have made the following changes to the interest rate forecasts table since the 2021/22 Treasury Management Strategy:

- LIBOR and LIBID rates ceased from the end of 2021. Work is currently progressing to replace LIBOR with a rate based on SONIA (Sterling Overnight

Index Average). The forecasts are based on expected average earnings by local authorities for 3 to 12 months.

- The forecasts for average earnings are averages i.e., rates offered by individual banks may differ significantly from these averages, reflecting their different needs for borrowing short term cash at any one point in time.

4.11.3 Over the last two years, the coronavirus outbreak has done huge economic damage to the UK and to economies around the world. After the Bank of England took emergency action in March 2020 to cut Bank Rate to 0.10%, it left the Bank Rate unchanged at its subsequent meetings until raising it to 0.25% at its meeting on 16 December 2021.

4.11.4 As shown in the forecast table above, the forecast for Bank Rate includes four increases, one in December 2021 to 0.25%, then quarter 2 of 2022 to 0.50%, quarter 1 of 2023 to 0.75%, quarter 1 of 2024 to 1.00% and, finally, one in quarter 1 of 2025 to 1.25%.

4.11.5 Since the start of 2021, there has been a lot of volatility in gilt yields and hence PWLB rates. As the interest forecast table for PWLB certainty rates above shows, there is forecast to be a steady, but slow, rise in both Bank Rate and gilt yields during the forecast period to March 2025, though there will be unpredictable volatility during this forecast period.

### **Investment and borrowing rates**

4.11.6 Investment returns are expected to improve in 2022/23. However, while markets are pricing in a series of Bank Rate hikes, actual economic circumstances may see the MPC fall short of these elevated expectations.

4.11.7 Borrowing interest rates fell to historically very low rates as a result of the Covid-19 crisis and the quantitative easing operations of the Bank of England and still remain at historically low levels. The policy of avoiding new borrowing by utilising cash or liquid balances has serviced the Council well over the last few years.

4.11.8 On 25 November 2020, the Chancellor announced the conclusion to the review of margins over gilt yields for PWLB rates which had been increased by 100 bps in October 2019. The standard and certainty margins were reduced by 100 bps but a prohibition was introduced to deny access to borrowing from the PWLB for any local authority which had purchase of assets for yield in its three-year capital programme. The current margins over gilt yields are as follows: -

- PWLB Standard Rate is gilt plus 100 basis points (G+100bps)
- PWLB Certainty Rate is gilt plus 80 basis points (G+80bps)
- PWLB HRA Standard Rate is gilt plus 100 basis points (G+100bps)
- PWLB HRA Certainty Rate is gilt plus 80bps (G+80bps)

- Local Infrastructure Rate is gilt plus 60bps (G+60bps)

4.11.9 The long-term (beyond 10 years), forecast for Bank Rate is 2.00%. As some PWLB certainty rates are currently below 2.00%, there remains value in considering long-term borrowing from the PWLB where appropriate. Temporary borrowing rates are likely, however, to remain near Bank Rate and may also prove attractive as part of a balanced debt portfolio. In addition, there are also some cheap alternative sources of long-term borrowing if an authority is seeking to avoid a “cost of carry” but also wishes to mitigate future re-financing risk.

**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 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	2021/22	2022/23	2023/24
Principal sums invested > 365 days	£40m	£50m	£50m

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

## 5 Current Portfolio Position

5.11 There is a favourable variance of £77k as at 31 December 2021, having achieved an investment income of £377k against a budget of £300k. However this is expected to reduce with a forecast year-end variance of £46k

5.12 The table below sets out the Council's full year forecast.

<b>Table 9: Investment Income Forecast 2021/22</b>			
	<b>Average Investment £'000</b>	<b>Estimated Return %</b>	<b>Investment Income £'000</b>
Core Investments	61,000	0.33%	204
Loans	5,207	4.65%	242
<b>Total / Average</b>	<b>66,207</b>	<b>0.67%</b>	<b>446</b>
<b>Budget</b>	<b>68,000</b>	<b>0.59%</b>	<b>400</b>
<b>Variance</b>	<b>(1,793)</b>	<b>0.08%</b>	<b>46</b>

5.13 The forecast interest surplus has arisen in part as a result of having greater than anticipated balances available to invest throughout 2021/22, due to:

- One year fixed term investments made in 2020/21 which had returns slightly above the budgeted return on core investments.
- Longer term investments, a two year and a three year fixed term investment with local authorities attracting higher interest rates in line with the Treasury Management Strategy.
- Favourable cash balances due to small business rates grants advanced from government and delays with approved capital projects.

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 £98.2m (as at December 2021), is expected to reduce to £66.2m by 31 March 2022. 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 and also the repayment of 2020/21 section 31 grants to central government.

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## **6 Annual Investment Strategy**

### **6.11 Investment Policy**

6.11.1 The Council's investment policy has regard to the Department of Levelling Up, Housing and Communities' (DLUHC) Guidance on Local Government Investments ("the Guidance"), the CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes 2017 ("the CIPFA TM Code") and CIPFA Treasury Management Guidance Notes 2018.

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 DLUHC 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 It is not expected the Bank Rate will increase quickly after the initial rate rise as the supply potential of the economy is not likely to have taken a major hit during the pandemic. The supply should be able to cope with meeting demand after supply shortages subside over the next year, without causing inflation to remain high in the medium-term, or to reduce inflation from falling back towards the MPC's 2% target after the spike up to around 5%. The forecast includes four increases in Bank Rate over the three-year forecast period to March 2025, ending at 1.25%.

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

- 2022 0.25%
- 2023 0.75%
- 2024 1.00%
- 2025 1.25%

6.12.3 There are risks included in the Bank Rate forecasts which include:

- Mutations of the Covid-19 virus which renders current vaccines ineffective, and tweaked vaccines to combat these mutations are delayed, or cannot be administered fast enough to prevent further lockdowns.
- Labour and supply shortages would prove to be disruptive and depress economic activity.
- The Monetary Policy Committee acting too quickly, or too far, over the next three years to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than expectations.
- The Monetary Policy Committee tightening monetary policy too late to ward off building inflationary pressures.
- The Government acting too quickly to cut expenditure to balance the national budget.
- UK / EU trade arrangements – if there was a major impact on trade flows and financial services due to complications or lack of co-operation in sorting out significant remaining issues.
- Major stock markets e.g., in the US, become increasingly judged as being over-valued and susceptible to major price corrections. Central banks become increasingly exposed to the “moral hazard” risks of having to buy shares and corporate bonds to reduce the impact of major financial market selloffs on the general economy.
- Geopolitical risks, for example in Ukraine, Iran, North Korea, but also in Europe and Middle Eastern countries; on-going global power influence struggles

between Russia/China/US. These could lead to increasing safe-haven flows.

### 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 DLUHC guidance which stresses "the prudent investment strategy of security, liquidity and yield". Investment regulations and DLUHC 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 DLUHC 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	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+	£6m	As per Link recommended

	Fitch Long term Rating (or equivalent)	Money and/or % Limit	Time Limit
	A		duration
<b>Part nationalised*</b> (Currently only RBS/Natwest fall into this category)	N/A	£10m	As per Link recommended duration – Currently 1yr
<b>Unrated Building Societies or with rating below A</b>	Min £3B Asset Size	£3m	6 Months
<b>Barclays Bank – Council’s banker</b> (in addition to Higher Quality Rated Bank limit above)	N/A	£5m	Daily limit
<b>DMADF</b>	AAA	unlimited	5yrs
<b>Local authorities</b>	N/A	£10m	5yrs
<b>Money market funds</b>	AAA	£10m	liquid
<b>Enhanced Money market funds</b>	AAA	£8m	liquid

6.16.2 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 in addition to holding up to £10m (higher quality rated bank limit) in either fixed term or other deposit accounts such as the instant access business premium account thus avoiding unnecessary 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**

### **7.1 Monitoring**

7.1.1 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.

### **7.2 MIFID**

7.2.1 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.

7.2.2 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 Council's competence to do so.

7.2.3 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.

7.2.4 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.