

APPENDIX 1

Treasury Management Strategy Statement 2019/20 And Prudential Indicators 2019/20 to 2021/22

Treasury Management Strategy for 2019/20

Contents

The strategy for 2019/20 covers:

1 Introduction

2 Training

3 Treasury Management Advisors

4 Prudential Indicators 2019/20 – 2021/22

Capital Expenditure Plans

Capital Financing Requirement (CFR)

Minimum revenue provision (MRP) Policy Statement

Investment Balances

Capital affordability indicators

Borrowing Requirements

Borrowing – Current position, Operational Boundary, Authorised limit

Treasury Limits

Interest rate projections

Policy on borrowing in advance of need

5 Current portfolio position

6 Annual Investment Strategy

Investment Policy

Types of investments

Prospects for interest rates

Creditworthiness Policy

Counterparty and Group limits

Time and monetary limits

Sovereign limits

Money Market Funds

Enhanced Money Market Funds

Main Bankers

Local Authority Mortgage Scheme (LAMS)

7 Risk Implications

8 Scheme of Delegation

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). This TMS has also been updated to include a number of recent changes 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 17.10.18 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 objective of the recent changes was to respond to the major expansion of local authority investment activity over the last few years into the purchase of non-financial investments, particularly property. This development has 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 existing Capital Strategy forms part of its Financial Strategy, this document is now being reviewed and updated to include these additional requirements and will be presented to members in a separate report.
- 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 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.
- 1.13 Revised reporting is required for the 2019/20 reporting cycle due to revisions of the Ministry of Housing Communities and Local Government (MHCLG)

Investment Guidance, the MHCLG Minimum Revenue Provision (MRP) Guidance, the CIPFA Prudential Code and the CIPFA Treasury Management Code. The primary reporting changes include the introduction of a capital strategy, to provide a longer-term focus to the capital plans, and greater reporting requirements surrounding any commercial activity undertaken under the Localism Act 2011. As referred to in paragraph 1.3 above, Hertsmere's Capital Strategy is being updated in this respect and will be reported separately.

2 Training

- 2.1 The CIPFA Code requires the Corporate Director 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 will be provided as necessary.

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 2019/20 – 2021/22

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 2018/19 to 2021/22 (report ref E/19/02)

Table 1 - Capital Expenditure

£'000	2018/19		2019/10	2020/21	2021/22	Total Budget 2019/20-2021/22
	Original	Forecast	Estimate	Estimate	Estimate	
Asset Management	5,394	3,716	285	995	0	1,280
Development Company	425	75	261	0	0	261
Planning & Building Control	80	0	80	0	0	80
Environmental Health	669	1,172	1,189	689	689	2,567
Partnerships & Community Support	4,800	4,000	1,000	0	0	1,000
Street Scene Services	1,676	1,088	511	238	0	749
Finance And Business Services	436	444	53	0	0	53
Human resources & Customer Services	0	0	150	0	0	150
Total	13,500	10,496	3,529	1,922	689	6,140
Financed by:						
Capital receipts	2,362	3,177	150	1,233	0	1,383
Disabled Facilities Grants	1,185	1,172	1,189	689	689	2,567
Housing Enabling Fund	54	148	80	0	0	80
Innovation and Investment Fund	3,355	295	411	0	0	411
Other Reserves	814	644	564	0	0	564
Revenue	100	4,008	1,055	0	0	1,055
S106/CIL	830	1,052	0	0	0	0
External Borrowing	4,800	0	0	0	0	0
Net financing need for the year	13,500	10,496	3,529	1,922	689	6,387

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. Whilst the loan to Hertsmere Leisure trust had originally been showing as being funded from borrowing it will now be funded from internal borrowing which will be replenished as the loan is repaid similar to other investments.

4.2.4 With a number of other development projects on the horizon such as the Civic Office North and investment through Hertsmere Developments Limited the borrowing requirement could rise substantially as these schemes progress.

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 is asked to approve the CFR projections below:**

CFR projections £000's	2017/18 Actual	2018/19 Est.	2019/20 Est.	2020/21 Est.	2021/22 Est.
Previous Year CFR B/Fwd	5,691	6,450	6,209	5,968	5,727
Net financing need for year	1,000	0	0	0	0
Less MRP and Financing movements	(241)	(241)	(241)	(241)	(241)
Total CFR	6,450	6,209	5,968	5,727	5,486

N.B.: the CFR reflects the current capital spending and financing requirements as set out in the draft Capital Programme 2019/20 to 2021/22. 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 Hertsmere Leisure Trust. 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. 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 £241k per annum with the remaining balance of £5.4m at 31 March 2018.
- 4.4.3 Various projects such as the proposed extension to the Civic Offices North and 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.
- 4.4.4 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 4.3.4 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 2018, the cumulative overpayment made is £4m, refer to paragraph 4.4.3.

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

Year End Resources £m	2018/19 Forecast	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
Total core funds	34	28	25	22
Working capital	7	9	9	9
Expected investments	41	37	34	31

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:

4.7.2 **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.

4.7.3 **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.

Table 4 - Affordability Indicators

	2017/18 Actual	2018/19 Forecast	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
Ratio of financing costs to net revenue	(2.70%)	(1.98%)	(1.41%)	(1.40%)	(1.39%)
Incremental impact of capital investment decisions on council tax band D -	£0.60	(£0.85)	(£6.76)	£1.24	£1.02

4.8 Borrowing Projections

4.8.1 The Council's anticipated Treasury position at 31 March 2017, with forward projections are summarised below.

Table 5 - Borrowing Projections

£m	2018/19 Original Estimate	2018/19 Revised Forecast	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
Actual gross debt at 31 March	4.800	0	0	0	0
The Capital Financing Requirement	5.450	6.209	5,968	5,727	5,486
Under / (over) borrowing	0.650	6.209	5,968	5,727	5,486

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 Corporate Director 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/19/02.

4.9 Treasury indicators: Limits to borrowing activity

4.9.1 **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.

4.9.2 **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.

1. 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.

2. The Council is asked to approve the following authorised limits:

Table 6 - Authorised Borrowing Limits

£m	2018/19 £m	2019/20 £m	2020/21 £m	2021/22 £m
Operational Boundary	28	40	50	60
Authorised Limit	30	45	55	65

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

Borrowing strategy

- 4.9.3 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 the extension of the Civic Centre and investment in Hertsmere Developments Limited with an 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)

- 4.9.4 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 carry does not outweigh the benefits of low rates.

UK Municipal Bonds Agency Plc

- 4.9.5 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

- 4.10.1 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	2018/19	2019/20	2020/21
	Upper	Upper	Upper
Borrowing - Variable	30%	30%	30%
Borrowing - Fixed	100%	100%	100%
Investments - Variable	75%	75%	75%
Investments - Fixed	100%	100%	100%
Maturity structure of fixed interest rate borrowing 2019/20			
		Lower	Upper
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%
Maturity structure of variable interest rate borrowing 2019/20			
		Lower	Upper
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 Asset Services as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. The following table gives their central view (as at November 2018).

Link Asset Services Interest Rate View														
	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22
Bank Rate View	0.75%	0.75%	1.00%	1.00%	1.00%	1.25%	1.25%	1.25%	1.50%	1.50%	1.75%	1.75%	1.75%	2.00%
3 Month LIBID	0.80%	0.90%	1.00%	1.10%	1.20%	1.30%	1.40%	1.50%	1.50%	1.60%	1.70%	1.80%	1.90%	2.00%
6 Month LIBID	0.90%	1.00%	1.20%	1.30%	1.40%	1.50%	1.60%	1.70%	1.70%	1.80%	1.90%	2.00%	2.10%	2.20%
12 Month LIBID	1.10%	1.20%	1.30%	1.40%	1.50%	1.60%	1.70%	1.80%	1.90%	2.00%	2.10%	2.20%	2.30%	2.40%
5yr PWLB Rate	2.00%	2.10%	2.20%	2.20%	2.30%	2.30%	2.40%	2.50%	2.50%	2.60%	2.60%	2.70%	2.80%	2.80%
10yr PWLB Rate	2.50%	2.50%	2.60%	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%
25yr PWLB Rate	2.90%	2.90%	3.00%	3.10%	3.10%	3.20%	3.30%	3.30%	3.40%	3.40%	3.50%	3.50%	3.60%	3.60%
50yr PWLB Rate	2.70%	2.70%	2.80%	2.90%	2.90%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.30%	3.40%	3.40%

4.11.2 Following the increase in Base rate by the MPC in August further rate rises are not expected until August 2019 as this is not expected before the March Brexit deadline. The increases will then be small with further increases not expected until May and November 2020. There however remains much uncertainty with these forecasts with much depending on the Brexit deal and the potential impact “no deal” could have on the economy.

4.11.3 Economic and interest rate forecasting remains difficult with so many external influences weighing on the UK. The above forecasts (and MPC decisions) will be liable to further amendment depending on how economic data and developments in financial markets transpire over the next year. Geopolitical developments, especially in the EU, could also have a major impact. Forecasts for average investment earnings beyond the three-year time horizon will be heavily dependent on economic and political developments.

Investment and borrowing rates

- Investment returns are likely to remain low during 2019/20 but to be on a gently rising trend over the next few years.
- Borrowing interest rates have been volatile so far in 2018-19 and have increased modestly since the summer. The policy of avoiding new borrowing by running down spare cash balances has served well over the last few years. However, this needs to be carefully reviewed to avoid incurring higher borrowing costs in the future when authorities may not be able to avoid new borrowing to finance capital expenditure and/or the refinancing of maturing debt;
- There will remain a cost of carry, (the difference between higher borrowing costs and lower investment returns), to any new long-term borrowing that causes a temporary increase in cash balances as this position will, most likely, incur a revenue cost.

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	2018/19	2019/20	2020/21
Principal sums invested > 365 days	£15m	£30m	£60m

N.B. this reflects the approved loan facilities to Hertsmere Leisure Trust (£5m) and Hertsmere Developments Limited (£50m).

5 Current Portfolio Position

- 5.1 The weighted average investment portfolio from April 2018 to November 2018 is £57.5m with an average return of 0.87%. Listed below are the average investment balances and the rate of return for the financial year 2018/2018 up to December together with a comparison of the position at 2016/17 year end.

Table 9 – Average return on investments

Investment Portfolio	01 April 17 to 31 March 18	01 April 17 to 30 Nov 2018
Average Balance	£52.7m	£57.5m
Average rate of return	0.61%	0.87%

- 5.2 As detailed below the current year forecast predicts a favourable variance of £270k by year-end (March 2018).

Table 10 – Investment income forecast

	Investment Average balance	Interest	Rate
Forecast:	£'000	£'000	%
Budget	41,600	200	0.48%
Forecast to 31/03/19	54,923	470	0.86%
Forecast favourable / (adverse) variance	11,323	270	0.38%

- 5.3 The forecast interest surplus has arisen in part as a result of having greater than anticipated balances available to invest throughout 2018/19, due to:

- Prudent and conservative budgeting of investment income.
- Delayed or re-profiled capital spend.
- Provisions in final accounts, which have yet to materialise in cash terms.

- 5.4 Investment rates have also risen following the UK base interest rate increase and with further increases also having been factored in for 2019 resulting in higher returns. Also there is interest from the loan to Hertsmere Leisure Trust as they have started drawing down the loan.

- 5.5 The investment portfolio, currently £66.3m (as at November), is expected to

reduce to £43.8m by the 31 March 2018. 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

6.1 Investment Policy

6.1.1 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.

6.1.2 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.

6.1.3 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.

6.1.4 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.

6.2 Interest rate expectations

6.2.1 Bank Rate is forecast to increase steadily but slowly over the next few years to reach 2.00% by quarter 1 2022. Bank Rate forecasts for financial year ends (March) are:

- 2018/19 0.75%
- 2019/20 1.25%
- 2020/21 1.50%
- 2021/22 2.00%

The overall balance of risks to economic growth in the UK is probably neutral.

The balance of risks to increases in Bank Rate and shorter term PWLB rates, are probably also even and are dependent on how strong GDP growth turns out, how slowly inflation pressures subside, and how quickly the Brexit negotiations move forward positively.

6.3 Types of Investments

6.3.1 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".

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

6.3.3 **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

6.3.4 **Non-specified Investments** - The Council's policy is to invest in non-specified investments, which meet all the criteria of the specified investments above. 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.

6.3.5 **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.

6.3.6 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.

6.4 **Creditworthiness policy**

6.4.1 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

6.4.2 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.

6.4.3 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

6.4.4 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.

6.4.5 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.

6.5 Counterparty and Group Limits

6.5.1 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 £8m per fund.

6.6 Time and monetary limits applying to investments.

6.6.1 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-	£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	£8m	liquid
Enhanced Money market funds	AAA	£8m	liquid

6.6.2 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.

6.7 Sovereign limits

6.7.1 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.

6.8 Current AAA Rated Countries by Fitch:

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

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

6.9 Money Market Funds (MMF)

6.9.1 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.

6.10 Enhanced Money Market Funds

6.10.1 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.

6.11 Main Bankers - Barclays

6.11.1 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 thus avoiding bank charges.

6.12 Unrated/lower rated Building Societies

6.13 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 Councils 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) Corporate 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.