

Welwyn Hatfield Borough Council

Treasury Management Strategy and  
Minimum Revenue Provision Policy



**WELWYN  
HATFIELD**

## 1 Introduction

- 1.1 Treasury Management is the management of the Council's cash flows, borrowing and investments and associated risks. This activity involves substantial sums of money and therefore involves exposure to financial risks such as loss of invested funds and impact on revenue due to changing interest rates. The successful identification, monitoring and control of these risks are therefore central to prudent financial management.
- 1.2 Treasury risk management at the Council is conducted within the framework of the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice 2017 Edition* (the CIPFA Code), which requires the approval of a treasury management strategy before the start of each year. This report also fulfils the Council's legal obligation under the *Local Government Act 2003* to have regard to the CIPFA Code.

## 2 Balance sheet summary and forecast

- 2.1 To take a view on likely treasury activity in 2019/20 it is necessary to look at the Council's balance sheet to estimate the level of funds available for investment purposes and any borrowing requirements, as shown in the table below:-

Table 1: Balance Sheet summary and Forecast

	31.3.18 Actual £'000	31.3.19 Estimate £'000	31.3.20 Forecast £'000	31.3.21 Forecast £'000	31.3.22 Forecast £'000
General Fund CFR	21,188	37,416	47,881	46,791	46,151
HRA CFR	242,248	246,631	241,987	250,297	245,961
<b>Total CFR</b>	<b>263,436</b>	<b>284,047</b>	<b>289,869</b>	<b>297,089</b>	<b>291,822</b>
Less: Other debt liabilities	(2,333)	(2,174)	(2,159)	(2,144)	(2,129)
<b>Loans CFR</b>	<b>261,103</b>	<b>281,873</b>	<b>287,710</b>	<b>294,945</b>	<b>289,693</b>
Less: Existing borrowing	(236,599)	(219,499)	(200,699)	(180,699)	(159,299)
<b>Under/(Over) borrowing</b>	<b>24,504</b>	<b>62,374</b>	<b>87,011</b>	<b>114,246</b>	<b>130,394</b>
Less: Usable reserves	(51,450)	(37,790)	(28,686)	(21,629)	(20,636)
Less: Working capital	(8,187)	(8,200)	(8,200)	(8,200)	(8,200)
New HRA Borrowing (Cumulative)		(27,132)	(41,288)	(69,598)	(86,372)
New GF Borrowing Requirement (Cumulative)			(18,837)	(24,819)	(25,186)
<b>Investments</b>	<b>35,133</b>	<b>10,748</b>	<b>10,000</b>	<b>10,000</b>	<b>10,000</b>

### **3 Borrowing strategy**

- 3.1 **Objectives:** The Council's primary objective when borrowing money is to strike an appropriately low risk balance between securing low interest costs and achieving certainty of those costs over the period for which funds are required. The flexibility to renegotiate loans should the Council's long term plans change is a secondary objective.
- 3.2 **Strategy:** The Council's underlying need to borrow for capital expenditure is termed the Capital Financing Requirement (CFR). It represents the amount of debt the Council needs to/has taken to fund the capital programme after repayments and Minimum Revenue Provision (MRP) are taken into account.
- 3.3 Whether external borrowing is taken out depends on the level of cash balances held by the Council. The finance team manage and monitor the Council's cash position to ensure sufficient funds are available to meet all requirements, taking advice from our treasury advisors Arlingclose Ltd in relation to timing and structure of borrowing.
- 3.4 This may be through utilising cash balances held by the Council (internal borrowing) in the short or medium term. When required and prudent, the Council will borrow externally from external bodies (such as the Government through Public Works Loan Board (PWLB) or the money markets).
- 3.5 At 1 April 2019 the Council will hold around £247m of long term HRA loans. The debt portfolio was originally structured to mirror projected cash surpluses arising from the HRA business plan on the introduction of self-financing, with all loans being repaid by 2028. The impact of changes in government policy, particularly the four year rent reduction policy, means that the Council will need to refinance part of its existing borrowing in future years. This refinancing is fully incorporated into the Council's 30 Year HRA Business Plan.
- 3.6 Within this Business Plan there is an additional borrowing requirement of £14.2m in 2019/20, to support the Affordable Housing Programme. The programme is continuing to see receipts from right to buy sales, however, the number of sales has started to reduce over the last year, and the programme has reduced in line with the projected income.
- 3.7 In addition to this, the Governments rent reduction policy has impacted on the Council's ability to repay loans as quickly as it intended. This means that in the medium term of the 30 Year HRA Business Plan, additional borrowing will be needed to extend the duration of the repayment period.
- 3.8 The General Fund borrowing requirement of £18.8m relates to the acquisition of properties in recent years to support economic development and regeneration of the town centres in the Borough.
- 3.9 The Council may also borrow in advance of need to take advantage of low interest rates, if deemed to be in the financial interests of the Council. Any borrowing in advance of need will not exceed the capital financing requirement for current plus 2 years.

- 3.10 Borrowing for short periods of time to cover unexpected cash flow shortages may also be undertaken.
- 3.11 **Sources of borrowing:** Approved sources of long-term and short-term borrowing will be:
- Public Works Loan Board and any successor body
  - any institution approved for investments
  - any other bank or building society authorised to operate in the UK
  - any other UK public sector body
  - UK public and private sector pension funds (except Hertfordshire Pension Fund)
  - capital market bond investors
  - special purpose companies created to enable local Council bond issues
- 3.12 **Other sources of debt finance:** In addition, capital finance may be raised by the following methods that are not borrowing, but may be classed as other debt liabilities:
- leasing
  - hire purchase
  - Private Finance Initiative
  - sale and leaseback
- 3.13 The Council has previously raised all of its long-term borrowing from the PWLB but will consider other sources of finance, such as local Council loans and bank loans that may be available at more favourable rates.
- 3.14 **Debt rescheduling:** The PWLB allows authorities to repay loans before maturity and either pay a premium or receive a discount according to a set formula based on current interest rates. The Council may take advantage of this and replace some loans with new loans, or repay loans without replacement, where this is expected to lead to an overall cost saving or a reduction in risk.

## **4 Investment Strategy**

- 4.1 The Council holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held and it is expected that investment balances are likely to range between £10m and £60m in the 2019/20 financial year.
- 4.2 **Objective:** Both the CIPFA Code and the MHCLG guidance require that funds be invested prudently and regard be given to the security and liquidity of investments before seeking the highest rate of return, or yield. The Council's objective when investing is therefore to strike a balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income.
- 4.3 **Negative interest rates:** If the UK enters into a recession in 2019/20 there is a small chance that the Bank of England could set its Bank Rate at or below zero, which is likely to feed through to negative interest rates on all low risk, short term investment options. This situation already exists in many other European countries. In this event, security will be measured as receiving the

contractually agreed amount at maturity, even though this may be less than the amount originally invested.

- 4.4 **Strategy:** Although investments balances are forecast to reduce in 2019/20, given the increased risk and low returns from short-term unsecured bank investments, it is the intention to continue to look for opportunities to diversify into more secure and/or higher yielding asset classes and to identify core cash that can be invested for longer periods to improve yield.
- 4.5 **Business models:** Under the new IFRS 9 standard, the accounting for certain investments depends on the Council's 'business model' for managing them. The Council aims to achieve value from its internally managed treasury investments by a business model of collecting the contractual cash flows and therefore, where other criteria are also met, these investments will continue to be accounted for at amortised cost.
- 4.6 **Approved investment counterparties:** The Council may invest its surplus funds with any of the counterparties in the following table, subject to the cash limits (per counterparty) and time limits shown. The table must be read in conjunction with the notes below.

Credit Rating	Banks Unsecured	Banks Secured	Government	Corporates	Registered Providers
UK Govt	n/a	n/a	£ Unlimited 50 years	n/a	n/a
AAA	£3m 5 years	£4m 20 years	£4m 50 years	£3m 20 years	£3m 20 years
AA+	£3m 5 years	£4m 10 years	£4m 25 years	£3m 10 years	£3m 10 years
AA	£3m 4 years	£4m 5 years	£4m 15 years	£3m 5 years	£3m 10 years
AA-	£3m 3 years	£4m 4 years	£4m 10 years	£3m 4 years	£3m 10 years
A+	£3m 2 years	£4m 3 years	£4m 5 years	£3m 3 years	£3m 5 years
A	£3m 13 months	£4m 2 years	£4m 5 years	£3m 2 years	£3m 5 years
A-	£3m 6 months	£4m 13 months	£3m 5 years	£3m 13 months	£3m 5 years
None	£1m 6 months	n/a	£3m 25 years	n/a	£3m 5 years
Pooled funds	£4m per fund				

- 4.7 **Credit Ratings:** Investment limits are set by reference to the lowest published long term credit rating from a selection of rating agencies. Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used. Investment decisions, however, are never made solely based on credit ratings and all other relevant factors, including external advice, will be taken into account.
- 4.8 **Banks Unsecured:** Accounts, deposits, certificates of deposit and senior unsecured bonds with banks and building societies, other than multilateral development banks. These investments are subject to the risk of credit loss via a bail-in should the regulator determine that the bank is failing or likely to fail.

- 4.9 **Banks Secured:** Covered bonds, reverse repurchase agreements and other collateralised arrangements with banks or building societies. These investments are secured on the bank's assets, which limits the potential losses in the unlikely event of insolvency, and means that they are exempt from bail-in. Where there is no investment specific credit rating, but the collateral upon which the investment is secured has a credit rating, the higher of the collateral credit rating and the counterparty credit rating will be used to determine cash and time limits. The combined secured and unsecured investments in any one bank will not exceed the cash limit for secured investments.
- 4.10 **Government:** Loans, bonds and bills issued or guaranteed by national governments, regional and local authorities and multilateral development banks. These investments are not subject to bail-in and there is generally a lower risk of insolvency. Investments with the UK Central Government may be made in unlimited amounts for up to 50 years.
- 4.11 **Corporates:** Loans, bonds and commercial paper issued by companies other than banks and registered providers. These investments are not subject to bail-in but are exposed to the risk of the company going insolvent.
- 4.12 **Registered Providers:** Loans and bonds issued by, guaranteed by or secured on the assets of registered providers of social housing and registered social landlords, formerly known as Housing Associations. These bodies are tightly regulated by the Regulator of Social Housing and, as providers of public services, they retain the likelihood of receiving government support if needed.
- 4.13 **Pooled Funds:** Shares or units in diversified investment vehicles consisting of any of the above investment types, plus equity shares and property. These funds have the advantage of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a fee. Short term Money Market Funds that offer same-day liquidity and very low or no volatility will be used alongside instant bank accounts, while pooled funds whose value changes with market prices and/or have a notice period will be used for longer investment periods.
- 4.14 Bond, equity and property funds offer enhanced returns over the longer term but are more volatile in the short term. These allow diversification into asset classes other than cash without the need to own and manage the underlying investments. As these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Council's investment objectives will be monitored regularly.
- 4.15 **HSBC Group:** As an exception to the criteria in the table above, the maximum limit for unsecured deposits in HSBC banking group is increased to £4m, subject to the bank's lowest long term credit rating remaining at A+ or above. This is to allow balances up to £1m to be invested in an interest bearing call account when it is not cost effective to place the funds elsewhere. Overnight balances in the Council's operating bank accounts at HSBC will not count towards their investment limit, on the basis that they cannot always be controlled and unexpected payments are often received.
- 4.16 **Investment Limits:** The maximum that will be lent to any one organisation (other than the UK government) will be £4m in order that no sum in excess of

available reserves is put at risk in the case of a single default. A group of banks under the same ownership will be treated as a single organisation for limit purposes. Limits will also be placed on investments in brokers' nominee accounts and industry sectors as below.

4.17 The Council's treasury advisors, Arlingclose Ltd, generally recommend a secured bank deposit limit of 30% of general fund reserves and unsecured limit of 15%, to ensure resilience in the event of a default. On the basis GF reserves before borrowing are anticipated to be £15m as at 31 March 2019, this would mean limits of £4.5m and £2.25m respectively. Due to the short dated nature of the majority of the Council's investments, and reserves being able to absorb more than one default, it is believed that the limits in the above table are currently acceptable. The situation will, however, be kept under continuous review.

	Cash limit
Any single organisation, except the UK Central Government	£4m each
UK Central Government	Unlimited
Any group of organisations under the same ownership	£4m per group
Any group of pooled funds under the same management	£4m per manager
Negotiable instruments held in a broker's nominee account	£10m per broker
Registered providers and registered social landlords	£6m in total
Money market funds	£28m in total

- 4.18 **Risk assessment and use of credit ratings:** Credit ratings are obtained and monitored by the Council's treasury advisors, who will notify changes in ratings as they occur. Where an entity has its credit rating downgraded so that it fails to meet the approved investment criteria then:
- no new investments will be made,
  - any existing investments that can be recalled or sold at no cost will be, and
  - full consideration will be given to recall or sale of all other existing investments with the affected counterparty.
- 4.19 Where a credit rating agency announces that a rating is on review for possible downgrade (also known as "rating watch negative" or "credit watch negative") so that it is likely to fall below the approved rating criteria, then only investments that can be withdrawn on the next working day will be made in that organisation until the outcome of the review is announced. This policy will not apply to negative outlooks, which indicate a long term direction of travel rather than an imminent change of rating.
- 4.20 **Other information on the security of investments:** The Council understands that credit ratings are good, but not perfect, predictors of investment default. Full regard will therefore be given to other available information on the credit quality of the organisations in which it invests, including credit default swap prices, financial statements, information on potential government support, reports in the quality financial press and analysis and advice from the Council's treasury management advisor. No investments will be made with an

organisation if there are substantive doubts about its credit quality, even though it may otherwise meet the above criteria.

- 4.21 When deteriorating financial market conditions affect the creditworthiness of all organisations, as in 2008 and 2011, this is not generally reflected in credit ratings, but can be seen in other market measures. In these circumstances, the Council will restrict its investments to those organisations of higher credit quality and reduce the maximum duration of its investments to maintain the required level of security. The extent of these restrictions will be in line with prevailing financial market conditions. If these restrictions mean that insufficient commercial organisations of “high credit quality” are available to invest the Council’s cash balances, then the surplus will be deposited with the UK Government, via the Debt Management Office or invested in government treasury bills for example, or with other local authorities. This will cause a reduction in the level of investment income earned, but will protect the principal sum invested.
- 4.22 **Other Treasury Management Issues:** Money Market Fund Regulatory Change - The Money Market Fund sector is now in the last stages of introducing new regulations, expected to be finalised in early 2019. These will see existing non-government Constant Net Asset Value (CNAV) funds convert to Low Volatility Net Asset Value (LVNAV) pricing. Government-type funds will remain as “CNAV” funds under the new regulations. This change is not expected to impact on the existing treasury Management strategy.
- 4.23 **Liquidity management:** The Council uses cash flow analysis to determine the maximum period for which funds may prudently be committed. The forecast is compiled on a prudent basis to minimise the risk of the Council being forced to borrow on unfavourable terms to meet its financial commitments. Limits on long term investments are set with reference to the Council’s medium term financial strategy and cash flow forecast.
- 4.24 **Interest Rate Risk:** The Council manages its exposure to fluctuations in interest rates with a view to containing interest costs and/or securing interest revenues, to meet budget expectations.
- 4.25 This is achieved through the prudent use of approved instruments, methods and techniques, primarily to create stability and certainty of costs and revenues, whilst retaining a sufficient degree of flexibility to take advantage of unexpected, potentially advantageous changes in the level or structure of interest rates. Advice is taken from advisors Arlingclose Ltd in this respect.

## **5 Treasury Management Indicators**

- 5.1 The Council measures and manages its exposures to treasury management risks using the following indicators:
- 5.2 Maturity structure of borrowing

This indicator is set to control the Council’s exposure to refinancing risk. The



upper and lower limits on the maturity structure of fixed rate borrowing will be:

Refinancing rate risk indicator	Upper Limit	Lower Limit
Under 12 months	20%	0%
12 months and within 24 months	30%	0%
24 months and within 5 years	50%	0%
5 years and within 10 years	80%	0%
10 years and within 20 years	100%	0%
20 years and above	100%	0%

Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment.

### 5.3 Principal sums invested for periods longer than a year

The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the total principal sum invested to final maturities beyond the period end will be:

	2019/20 £'000	2020/21 £'000	2021/22 £'000
Limit on principal invested beyond year end	10,000	5,000	5,000

### 5.4 Borrowing Limits

The Council is being asked to approve these Prudential Indicators as part of its requirement to set limits on borrowing activity.

Authorised Limit	2019/20 £000	2020/21 £000	2021/22 £000
General Fund Borrowing	27,000	33,000	33,000
Other Long Term Liabilities	2,159	2,144	2,129
Housing Revenue Account Borrowing	304,799	304,799	304,799
<b>Total</b>	<b>333,958</b>	<b>339,943</b>	<b>339,928</b>

The authorised limit is the affordable borrowing limit determined in compliance with the Local Government Act 2003. It is the maximum amount of debt that the Council can legally owe. The authorised limit provides headroom over and above the operational boundary for unusual cash movements.

<b>Operational Boundary</b>	<b>2019/20</b>	<b>2020/21</b>	<b>2021/22</b>
	<b>£000</b>	<b>£000</b>	<b>£000</b>
General Fund Borrowing	18,837	24,819	25,186
Other Long Term Liabilities	2,159	2,144	2,129
Housing Revenue Account Borrowing	241,987	250,297	245,961
<b>Total</b>	<b>262,983</b>	<b>277,260</b>	<b>273,276</b>

The operational boundary is based on the Council's estimate of most likely (i.e. prudent but not worst case) scenario for external debt. It links directly to the Council's estimates of capital expenditure, the capital financing requirement and cash flow requirements, and is a key management tool for in-year monitoring. Other long-term liabilities comprise of a finance lease and forms part of the Council's debt.

## **6 Policy on Use of Financial Derivatives**

- 6.1 The CIPFA Code does require authorities to clearly detail their policy on the use of derivatives in the annual strategy. The council does not plan to use derivatives currently.
- 6.2 If required, the Council will only use standalone financial derivatives (such as swaps, forwards, futures and options) where they can be clearly demonstrated to reduce the overall level of the financial risks that the Council is exposed to. Additional risks presented, such as credit exposure to derivative counterparties, will be taken into account when determining the overall level of risk. Embedded derivatives, including those present in pooled funds and forward starting transactions, will not be subject to this policy, although the risks they present will be managed in line with the overall treasury risk management strategy.
- 6.3 Financial derivative transactions may be arranged with any organisation that meets the approved investment criteria. The current value of any amount due from a derivative counterparty will count against the counterparty credit limit and the relevant foreign country limit.

## **7 Markets in Financial Instruments Directive**

- 7.1 The Council has opted up to professional client status with its providers of financial services, including advisors, banks, brokers and fund managers, allowing access to a greater range of services but without the greater regulatory protections afforded to individuals and small companies. Given the size and range of the Council's treasury management activities the Corporate Director (Resources, Environment and Cultural Services) believes this to be the most appropriate status.

## **8 Policy on apportioning interest to the Housing Revenue Account**

- 8.1 On 1 April 2012, the Council assigned the entire long term loans portfolio to the HRA pool and in the future, new long-term loans borrowed will also be assigned in their entirety to either the General Fund or the HRA pool. Interest payable and other costs/income arising from long-term loans (e.g. premiums and discounts on early redemption) will be charged/credited to the respective revenue account.
- 8.2 Differences between the value of the HRA loans pool and the HRA's underlying need to borrow (adjusted for HRA balance sheet resources available for investment) will result in a notional cash balance which may be positive or negative. This balance will be measured each month and interest transferred between the General Fund and HRA at the Council's average rate on investments, adjusted by credit risk.

## **9 Policy on the Council's Minimum Revenue Position**

- 9.1 Where the Council finances General Fund capital expenditure by debt, it must put aside resources to repay that debt in later years. The amount charged to the revenue budget for the repayment of debt is known as Minimum Revenue Provision (MRP), although there has been no statutory minimum since 2008. The Local Government Act 2003 requires the Council to have regard to the Department for Communities and Local Government's Guidance on Minimum Revenue Provision (the Ministry for Housing, Communities and Local Government Guidance) most recently issued in 2018.
- 9.2 The broad aim of prudent provision is to require local authorities to put aside revenue over time to cover their capital financing requirement. In doing so, local authorities should align the period over which they charge MRP to one that is commensurate with the period over which their capital expenditure provides benefits.
- 9.3 The MHCLG Guidance requires the Council to approve an Annual MRP Statement each year, and recommends a number of options for calculating a prudent amount of MRP.
- 9.4 The Council's policy for the calculation of MRP shall be the Asset Life Method (Option 3 of the guidance), the principal (capital) element reflects the true nature of the rent/ charge over the life of the assets.
- 9.5 All assets will have the MRP calculated on an equal instalment basis, where a charge is made equal to the element of the charge that goes to write down the balance sheet liability.
- 9.6 The Council's policy is to charge MRP from the financial year following completion of the capital scheme / purchase.
- 9.7 Based on these policies, the Council's estimated MRP for 2019/20 is £814k which is included in the budget as part of the Capital Financing Costs.

## 10 Economic update provided by Arlingclose Ltd (External Context)

10.1 The following section has been provided by the Council's treasury management advisors to provide some economic context to support the Council's Strategy.

Underlying assumptions:

- The Bank of England's Monetary Policy Committee (MPC) left Bank Rate unchanged at the September meeting, after voting unanimously to increase Bank Rate to 0.75% in August.
- Our projected outlook for the UK economy means we maintain the significant downside risks to our interest rate forecast. The UK economic environment is relatively soft, despite seemingly strong labour market data. GDP growth recovered somewhat in Q2 2018, but the annual growth rate of 1.2% remains well below the long term average. Our view is that the UK economy still faces a challenging outlook as the country exits the European Union and Eurozone economic growth softens.
- Cost pressures were projected to ease but have risen more recently and are forecast to remain above the Bank's 2% target through most of the forecast period. The rising price of oil and tight labour market means inflation may remain above target for longer than expected. This means that strong real income growth is unlikely in the near future.
- The MPC has a bias towards tighter monetary policy but is reluctant to push interest rate expectations too strongly. We believe that MPC members consider both that: 1) ultra-low interest rates result in other economic problems, and 2) higher Bank Rate will be a more effective policy weapon should downside Brexit risks crystallise.
- The global economy appears to be slowing, particularly the Eurozone and China, where the effects of the trade war has been keenly felt. Despite slower growth, the European Central Bank (ECB) is adopting a more strident tone in conditioning markets for the end of quantitative easing, the timing of the first rate hike (2019) and their path thereafter. Meanwhile, European political issues, mostly lately with Italy, continue.
- The US economy is expanding more rapidly. The Federal Reserve has tightened monetary policy by raising interest rates to the current 2%-2.25% range; further rate hikes are likely, which will start to slow economic growth. Central bank actions and geopolitical risks have and will continue to produce significant volatility in financial markets, including bond markets.

Forecast:

- The MPC has maintained expectations of a slow rise in interest rates over the forecast horizon. Our central case is for Bank Rate is to rise twice in 2019. The risks are weighted to the downside.
- Gilt yields have remained at low levels. We expect some upward movement from current levels based on our interest rate projections, the strength of the US economy and the ECB's forward guidance on higher rates. However, volatility arising from both economic and political events will continue to offer borrowing opportunities.