Appendix A

Treasury Management Strategy 2017/18 to 2020/21 and Prudential Indicators

The Capital Prudential Indicators 2017/18 to 2020/21

The Council's capital expenditure plans are the key driver of treasury management activity. The output of the capital expenditure plans is reflected in the prudential indicators, which are designed to assist members' overview and confirm capital expenditure plans.

Capital Expenditure

This prudential indicator is a summary of the Council's capital expenditure plans, both those agreed previously, and those forming part of this budget cycle. Members of Full Council are asked to approve the capital expenditure forecasts:

Table 1

Capital expenditure	2015/16 Actual	2016/17 Estimate (Forecast) *	2017/18 Estimate *	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate
Commercialisation	3,268,868	5,904,115	2,491,550	150,000	150,000	150,000
Strategy & Governance	589,621	685,241	-	-	1,150,000	-
Place	1,746,189	1,826,017	2,637,112	1,005,000	866,500	815,000
Capital Loans	128,148	1,370,518	393,137	-	-	-
Total	**5,732,826**	**9,785,891**	**5,521,799**	**1,155,000**	**2,166,500**	**965,000**

*£3,183,662 is requested to be carried over from 2016/17 to future years at Council 23rd February 2017 as part of the budget setting report, so this carry over amount is not yet approved

Other long term liabilities. The above financing need excludes other long term liabilities, such as PFI and leasing arrangements which already include borrowing instruments.

The table below summarises the above capital expenditure plans and how these plans are being financed by capital or revenue resources. Any shortfall of resources results in a funding borrowing need.

Table 2

Capital expenditure	2015/16 Actual	2016/17 Estimate (Forecast) *	2017/18 Estimate *	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate
Total	**5,732,826**	**9,785,891**	**5,521,799**	**1,155,000**	**2,166,500**	**965,000**
Financed by:						
Capital grants	754,100	1,321,669	1,026,853	534,552	534,552	534,552
Capital reserves	4,039,023	7,011,283	4,101,809	620,448	681,948	430,448
Internal Borrowing	-	-	-	-	-	-
Revenue	811,555	82,421	-	-	950,000	-
Capital Loans	128,148	1,370,518	393,137	-	-	-
Net financing need for the year	**Nil**	**Nil**	**Nil**	**Nil**	**Nil**	**Nil**

The Council's borrowing need (the Capital Financing Requirement)

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

The CFR does not increase indefinitely, as the minimum revenue provision (MRP) is a statutory annual revenue charge which broadly reduces the borrowing need in line with each assets life.

The CFR includes any other long term liabilities (e.g. PFI schemes, finance leases). Whilst these increase the CFR, and therefore the Council's borrowing requirement, these types of scheme include a borrowing facility and so the Council is not required to separately borrow for these schemes. The Council currently has £8.726m of such schemes within the CFR.

Table 3: The Full Council is recommended to approve the CFR projections below:

£'000	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate
Capital Financing Requirement					
Opening CFR	**(374)**	**(2,517)**	**(453)**	**(130)**	**254**
Movement in CFR	**(2,143)**	**2,064**	**323**	**384**	**315**
Closing CFR	**(2,517)**	**(453)**	**(130)**	**254**	**569**

This table indicates that the Council has a borrowing need within this reporting period. However, as per the budget report to Council (23rd February 2017), the intention is to borrow internally and not undertake any external borrowing whilst it is not required. The CFR will need to be monitored closely to ensure future capital expenditure remains affordable. The Investment Fund and Growth Fund provide an option for additional funding subject to meeting the defined returns and as per the Capital strategy, any Government funding available for specific initiatives will be sought to enable projects to be self -financing. Any further decision to borrow for capital projects would only be supported if the business case for the projects does not place additional cost pressure on the tax payer through the council tax charge. The council would not undertake any un-supported borrowing whilst it still has reasonable capital receipt resources available. Regulations require the full Council to approve its 'Prudential Indicators' at least annually.

Minimum revenue provision (MRP) policy statement
The Council is required to pay off an element of the accumulated General Fund 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).

DCLG regulations have been issued which require the full Council to approve **an MRP Statement** in advance of each year. A variety of options are provided to councils, so long as there is a prudent provision. The full Council is recommended to approve the following MRP Statement:

- Breckland has fully financed its capital expenditure incurred before 1st April 2008, therefore there is no MRP requirement anticipated, other than for the PFI schemes. However, in the unlikely event of an MRP charge being required, the policy for approval is:
- **Asset life method** – MRP will be based on the estimated life of the assets, in accordance with the regulations (this option must be applied for any expenditure capitalised under a Capitalisation Direction) (option 3);

This option provides for a reduction in the borrowing need over approximately the asset's life. Repayments included in annual PFI or finance leases are applied as MRP.

Core funds and expected investment balances
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 ongoing 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 4

Year End Resources £m	**2016/17 Estimate**	**2017/18 Estimate**	**2018/19 Estimate**	**2019/20 Estimate**	**2020/21 Estimate**
Earmarked reserves	8.699	7.218	6.545	5.425	5.510
Capital receipts	-	-	-	-	-
Total core funds	8.699	7.218	6.545	5.425	5.510
Working capital*	**5.0**	**5.0**	**5.0**	**5.0**	**5.0**
Expected investments	**28**	**21**	**19**	**17**	**17**

*Working capital balances shown are estimated year end; these may be higher mid year

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

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. Where financing costs to net revenue stream are negative, this is because the Council is earning interest on its balances as opposed to paying interest on its borrowing.

Table 5

%	**2017/18 Estimate**	**2018/19 Estimate**	**2019/20 Estimate**	**2020/21 Estimate**
Non-HRA	**0.19%**	**0.33%**	**(0.24)%**	**(0.16)%**

The estimates of financing costs include current commitments and the proposals in this budget report.

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, such as the level of Government support, which are not certain over a three year period.

Table 6
Incremental impact of capital investment decisions on the band D council tax

£	**2017/18 Estimate**	**2018/19 Estimate**	**2019/20 Estimate**	**2020/21 Estimate**
Council tax - band D	£0.07	£0.01	£0.03	£0.03

The above figures are low due to interest rate levels and they make no allowance for the cost of borrowing if required.

The Treasury Management Strategy 2017-18 to 2020-21

Borrowing

The capital expenditure plans set out in the prudential indicators (above) provide details of the service activity of the Council. The treasury management function ensures that the Council's cash is organised in accordance with the relevant professional codes, so that sufficient cash is available to meet this service activity. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of appropriate borrowing facilities. The strategy covers the relevant treasury / prudential indicators, the current and projected debt positions and the annual investment strategy.

Current portfolio position
The Council's treasury portfolio position at 31 March 2016, with forward projections are summarised below. The table shows the actual external debt (the treasury management operations), against the underlying capital borrowing need (the Capital Financing Requirement - CFR), highlighting any over or under borrowing.

Table 7

£'000	2015/16 Actual	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate
External Debt						
Actual gross debt at 31 March	-	-	-	-		-
The Capital Financing Requirement	(374)	(2,517)	(453)	(130)	254	569

Within the prudential indicators there are a number of key indicators to ensure that the Council operates its activities within well defined limits. One of these is that 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 2017/18 and the following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes.

The Executive Director Commercialisation & S151 reports that the Council complied with this prudential indicator in the current year. However, as detailed under table 3, the CFR will need to be monitored closely to ensure that future capital expenditure remains affordable. This view takes into account current commitments, existing plans, and the proposals in this budget report.

Treasury Indicators: limits to borrowing activity
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.

Table 8

Operational boundary £m	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate
Debt	-	-	-	-	
Other long term liabilities	8.726	8.508	8.278	8.035	7.780
Total	8.726	8.508	8.278	8.035	7.780

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 full Council is recommended to approve the following authorised limit:

Table 9

Authorised limit £m	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate
Debt (Bank overdraft)	0.250	0.250	0.250	0.250	0.250
Other long term liabilities	8.726	8.508	8.278	8.035	7.780
Total	8.976	8.758	8.528	8.285	8.030

Borrowing strategy

It is not anticipated that the Council will undertake long term borrowing during the next three years but short term use of cash balances (internal borrowing of approx. 0.569m) is anticipated to fund the capital programme. The Council's borrowing strategy will need to be monitored closely. Should a more detailed borrowing strategy be required, this will be prepared and put forward for approval prior to any borrowing taking place.

Treasury management limits on activity

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 will impair the opportunities to reduce costs / improve performance. The indicators 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.

Table 10

The full Council is recommended to approve the following treasury indicators and limits:

£m	2017/18	2018/19	2019/20	2020/21
Interest rate exposures				
	Upper	**Upper**	**Upper**	**Upper**
Limits on fixed interest rates based on net debt	£0	£0	£0	£0
Limits on variable interest rates based on net debt	£0	£0	£0	£0

Policy on borrowing in advance of need

It is not anticipated that the Council will undertake external or long term borrowing during the next three years. However, this will need to be monitored closely. Should a more detailed borrowing strategy be required, this will be prepared and put forward for approval prior to any borrowing taking place.

Municipal Bonds Agency
Should the Council make a decision to borrow, it will consider loans offered by the Municipal Bonds Agency.

Prospects for interest rates (as at 16/11/2017)
The Council has appointed Capita 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.

Table 11

Annual Average %	Bank Rate %	PWLB Borrowing Rates % (including certainty rate adjustment)		
		5 year	25 year	50 year
Mar 2017	0.25	1.60	2.90	2.70
Jun 2017	0.25	1.60	2.90	2.70
Sep 2017	0.25	1.60	2.90	2.70
Dec 2017	0.25	1.60	3.00	2.80
Mar 2018	0.25	1.70	3.00	2.80
Jun 2018	0.25	1.70	3.00	2.80
Sep 2018	0.25	1.70	3.10	2.90
Dec 2018	0.25	1.80	3.10	2.90
Mar 2019	0.25	1.80	3.20	3.00
Jun 2019	0.50	1.90	3.20	3.00
Sep 2019	0.50	1.90	3.30	3.10
Dec 2019	0.75	2.00	3.30	3.10
Mar 2020	0.75	2.00	3.40	3.20

Commentry from Capita (16/11/2017)
The Monetary Policy Committee, (MPC), cut Bank Rate from 0.50% to 0.25% on 4th August in order to counteract what it forecast was going to be a sharp slowdown in growth in the second half of 2016. It also gave a strong steer that it was likely to cut Bank Rate again by the end of the year. However, economic data since August has indicated much stronger growth in the second half 2016 than that forecast; also, inflation forecasts have risen substantially as a result of a continuation of the sharp fall in the value of sterling since early August. Consequently, Bank Rate was not cut again in November and, on current trends, it now appears unlikely that there will be another cut, although that cannot be completely ruled out if there was a significant dip downwards in economic growth. During the two-year period 2017 – 2019, when the UK is negotiating the terms for withdrawal from the EU, it is likely that the MPC will do nothing to dampen growth prospects, (i.e. by raising Bank Rate), which will already be adversely impacted by the uncertainties of what form Brexit will eventually take. Accordingly, a first increase to 0.50% is not tentatively pencilled in, as in the table above, until quarter 2 2019, after those negotiations have been concluded, (though the period for negotiations could be extended). However, if strong domestically generated inflation, (e.g. from wage increases within the UK), were to emerge, then the pace and timing of increases in Bank Rate could be brought forward.

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.

The overall longer run trend is for gilt yields and PWLB rates to rise, albeit gently. It has long been expected that at some point, there would be a start to a switch back from bonds to equities after a historic long term trend over about the last twenty five years of falling bond yields. The action of central banks since the financial crash of 2008, in implementing substantial quantitative easing purchases of bonds, added further impetus to this downward trend in bond yields and rising prices of bonds. The opposite side of this coin has been a rise in equity values as investors searched for higher returns and took on riskier assets. The sharp rise in bond yields since the US Presidential election, has called into question whether, or when, this trend has, or may, reverse, especially when America is likely to lead the way in reversing monetary policy. Until 2015, monetary policy was focused on providing stimulus to economic growth but has since started to refocus on countering the threat of rising inflationary pressures as strong economic growth becomes more firmly established. The expected substantial rise in the Fed. rate over the next few years may make holding US bonds much less attractive and cause their prices to fall, and therefore bond yields to rise. Rising bond yields in the US would be likely to exert some upward pressure on bond yields in other developed countries but the degree of that upward pressure is likely to be dampened by how strong, or weak, the prospects for economic growth and rising inflation are in each country, and on the degree of progress in the reversal of monetary policy away from quantitative easing and other credit stimulus measures.

PWLB rates and gilt yields have been experiencing exceptional levels of volatility that have been highly correlated to geo-political, sovereign debt crisis and emerging market developments. It is likely that these exceptional levels of volatility could continue to occur for the foreseeable future.

The overall balance of risks to economic recovery in the UK is to the downside, particularly in view of the current uncertainty over the final terms of Brexit and the timetable for its implementation.

Apart from the above uncertainties, **downside risks to current forecasts** for UK gilt yields and PWLB rates currently include:

- Monetary policy action by the central banks of major economies reaching its limit of effectiveness and failing to stimulate significant sustainable growth, combat the threat of deflation and reduce high levels of debt in some countries, combined with a lack of adequate action from national governments to promote growth through structural reforms, fiscal policy and investment expenditure.
- Major national polls:
  - Italian constitutional referendum 4.12.16;
  - Spain has a minority government with only 137 seats out of 350 after already having had two inconclusive general elections in 2015 and 2016. This is potentially highly unstable.
  - Dutch general election 15.3.17;
  - French presidential election April/May 2017;
  - French National Assembly election June 2017;
  - German Federal election August – October 2017.
- A resurgence of the Eurozone sovereign debt crisis, with Greece being a particular problem, and stress arising from disagreement between EU

countries on free movement of people and how to handle a huge influx of immigrants and terrorist threats

- Weak capitalisation of some European banks, especially Italian.
- Geopolitical risks in Europe, the Middle East and Asia, causing a significant increase in safe haven flows.
- UK economic growth and increases in inflation are weaker than we currently anticipate.
- Weak growth or recession in the UK's main trading partners - the EU and US.

The potential for **upside risks to current forecasts** for UK gilt yields and PWLB rates, especially for longer term PWLB rates, include: -

- UK inflation rising to significantly higher levels than in the wider EU and US, causing an increase in the inflation premium in gilt yields.
- A rise in US Treasury yields as a result of Fed. funds rate increases and rising inflation expectations in the USA, dragging UK gilt yields upwards.
- The pace and timing of increases in the Fed. funds rate causing a fundamental reassessment by investors of the relative risks of holding bonds as opposed to equities and leading to a major flight from bonds to equities.
- A downward revision to the UK's sovereign credit rating undermining investor confidence in holding sovereign debt (gilts).

Investment and borrowing rates

- Investment returns are likely to remain low during 2017/18 and beyond;
- Borrowing interest rates have been on a generally downward trend during most of 2016 up to mid-August; they fell sharply to historically phenomenally low levels after the referendum and then even further after the MPC meeting of 4th August when a new package of quantitative easing purchasing of gilts was announced. Gilt yields have since risen sharply due to a rise in concerns around a 'hard Brexit', the fall in the value of sterling, and an increase in inflation expectations. 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 later times when authorities will not be able to avoid new borrowing to finance capital expenditure and/or to refinance maturing debt;
- There will remain a cost of carry to any new long-term borrowing that causes a temporary increase in cash balances as this position will, most likely, incur a revenue cost – the difference between borrowing costs and investment returns.

<u>(End of Capita commentary)</u>

The Council will be mindful of the above comments when formulating it's borrowing strategy