Appendix A

Treasury Management Strategy 2018/19 to 2021/22 and Prudential Indicators

The Capital Prudential Indicators 2018/19 to 2021/22

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 Governance and Audit Committee are asked to recommend to Full Council to approve the capital expenditure forecasts:

Table 1

Capital expenditure £	2016/17 Actual	2017/18 Estimate* (Forecast)	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
Commercialisation	5,457,607	3,734,181	2,296,000	3,283,000	2,150,000	2,455,241
Strategy & Governance	60,020	500,000	200,000	1,150,000	-	-
Place	1,830,668	1,991,125	2,878,029	1,235,000	1,210,000	1,210,000
Capital Loans	1,256,164	610,219	463,376	-	-	-
Total	**8,604,459**	**6,835,525**	**5,837,405**	**5,668,000**	**3,360,000**	**3,665,241**

* This is in line with draft budget report to Cabinet 28 November 2017.

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 £	2016/17 Actual	2017/18 Estimate (Forecast) *	2018/19 Estimate *	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
Total	**8,604,459**	**6,835,525**	**5,837,405**	**5,668,000**	**3,360,000**	**3,665,241**
Financed by:						
Capital grants	1,301,526	2,582,488	2,402,022	2,136,721	1,003,721	1,003,721
Capital reserves	5,558,036	3,642,818	1,872,007	481,279	356,279	356,279
Internal Borrowing	-	-	-	-	-	-
Revenue	488,733	-	1,100,000	3,050,000	2,000,000	2,305,241
Capital Loans	1,256,164	610,219	463,376	-	-	-
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 £8,508k of such schemes within the CFR.

Table 3: The Governance and Audit Committee is requested to recommend to Full Council to approve the CFR projections below:

£'000	**2017/18 Estimate**	**2018/19 Estimate**	**2019/20 Estimate**	**2020/21 Estimate**	**2021/22 Estimate**
Capital Financing Requirement					
Opening CFR	(2,792)	(707)	(221)	(12)	253
Movement in CFR	2,085	486	209	265	262
Closing CFR	**(707)**	**(221)**	**(12)**	**253**	**515**

This table indicates that the Council has a borrowing need within this reporting period through over programming. However, as per the draft budget report to Cabinet (28 November 2017), this will be re-visited in future years budget setting as the capital programme is reviewed. The CFR will need to be monitored closely to ensure future capital expenditure remains affordable. The Investment 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 Governance and Audit Committee is requested to recommend to Full Council 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 £'000	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
Earmarked reserves	13,141	13,831	12,516	10,804	8,325
Capital receipts	-	-	-	-	-
Total core funds	13,141	13,831	12,516	10,804	8,325
Working capital*	**5,000**	**5,000**	**5,000**	**5,000**	**5,000**
Expected investments	**19,000**	**18,000**	**17,000**	**17,000**	**16,000**

*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 Governance & Audit Committee is requested to recommend to Full Council 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

%	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
Non-HRA	**(1.73%)**	**(1.86%)**	**(1.70%)**	**(1.59%)**

The estimates of financing costs include current commitments and the proposals in the draft 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 draft 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

£	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
Council tax - band D	£0.02	£0.02	£0.02	£0.02

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 2018-19 to 2021-22

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 2017, with forward projections, is 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	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
External Debt					
Actual gross debt at 31 March	**-**	**-**	**-**	**-**	**-**
The Capital Financing Requirement	**(707)**	**(221)**	**(12)**	**253**	**515**

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 2018/19 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 Officer 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 the draft 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 £'000	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
Debt	-	-	-	-	
Other long term liabilities	8,508	8,278	8,035	7,780	7,511
Total	8,508	8,278	8,035	7,780	7,511

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 Governance and Audit Committee is requested to recommend to Full Council to approve the following authorised limit:

Table 9

Authorised limit £'000	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
Debt (Bank overdraft)	0,250	0,250	0,250	0,250	0,250
Other long term liabilities	8,508	8,278	8,035	7,780	7,511
Total	8,758	8,528	8,285	8,030	7,761

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 (over programming of approx. £515k) 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 is 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 Governance and Audit Committee is requested to recommend to Full Council to approve the following treasury indicators and limits:

£'000	2018/19	2019/20	2020/21	2021/22
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 20/11/2017)
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.

Table 11

Annual Average %	Bank Rate %	PWLB Borrowing Rates % (including certainty rate adjustment)		
		5 year	25 year	50 year
Mar 2018	0.50	1.60	2.90	2.60
Jun 2018	0.50	1.60	3.00	2.70
Sep 2018	0.50	1.70	3.00	2.80
Dec 2018	0.75	1.80	3.10	2.90
Mar 2019	0.75	1.80	3.10	2.90
Jun 2019	0.75	1.90	3.20	3.00
Sep 2019	0.75	190	3.20	3.00
Dec 2019	1.00	2.00	3.30	3.10
Mar 2020	1.00	2.10	3.40	3.20
Jun 2020	1.00	2.10	3.50	3.30
Sep 2020	1.25	2.20	3.50	3.30
Dec 2020	1.25	2.30	3.60	3.4
Mar 2021	1.25	2.30	3.60	3.40

Commentry from Link Asset Services (16/11/2017)
As expected, the Monetary Policy Committee (MPC) delivered a 0.25% increase in Bank Rate at its meeting on 2 November. This removed the emergency cut in August 2016 after the EU referendum. The MPC also gave forward guidance that they expected to increase Bank rate only twice more by 0.25% by 2020 to end at 1.00%. The Link Asset Services forecast as above includes increases in Bank Rate of 0.25% in November 2018, November 2019 and August 2020.
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 more protracted move from bonds to equities after a historic long-term trend, over about the last 25 years, of falling bond yields. The action of central banks since the financial crash of 2008, in implementing substantial Quantitative Easing, added further impetus to this downward trend in bond yields and rising bond prices. Quantitative Easing has also directly led to 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 in November 2016 has called into question whether the previous trend may go into reverse, especially now the Fed. has taken the lead in reversing monetary policy by starting, in October 2017, a policy of not fully reinvesting proceeds from bonds that it holds when they mature.

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 stronger economic growth becomes more firmly established. The Fed. has started raising interest rates and this trend is expected to continue during 2018 and 2019. These increases will 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 are likely to exert some upward pressure on bond yields in the UK and other developed economies. However, 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 towards the reversal of monetary policy away from quantitative easing and other credit stimulus measures.

From time to time, gilt yields – and therefore PWLB rates - can be subject to exceptional levels of volatility due to geo-political, sovereign debt crisis and emerging market developments. Such volatility could occur at any time during the forecast period.

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 balance of risks to economic recovery in the UK is probably to the downside, particularly with the current level of uncertainty over the final terms of Brexit.

Downside risks to current forecasts for UK gilt yields and PWLB rates currently include:

- Bank of England monetary policy takes action too quickly over the next three years to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than we currently anticipate.
- Geopolitical risks, especially North Korea, but also in Europe and the Middle East, which could lead to increasing safe haven flows.
- A resurgence of the Eurozone sovereign debt crisis, possibly Italy, due to its high level of government debt, low rate of economic growth and vulnerable banking system.
- Weak capitalisation of some European banks.
- The result of the October 2017 Austrian general election is likely to result in a strongly anti-immigrant coalition government. In addition, the new Czech prime minister is expected to be Andrej Babis who is strongly against EU migrant quotas and refugee policies. Both developments could provide major impetus to other, particularly former Communist bloc countries, to coalesce to create a major block to progress on EU integration and centralisation of EU policy. This, in turn, could spill over into impacting the Euro, EU financial policy and financial markets.
- Rising protectionism under President Trump
- A sharp Chinese downturn and its impact on emerging market countries

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

- The Bank of England is too slow in its pace and strength of increases in Bank Rate and, therefore, allows inflation pressures to build up too strongly within the UK economy, which then necessitates a later rapid series of increases in Bank Rate faster than we currently expect.
- UK inflation returning to sustained significantly higher levels causing an increase in the inflation premium inherent to gilt yields.
- The Fed causing a sudden shock in financial markets through misjudging the pace and strength of increases in its Fed. Funds Rate and in the pace and strength of reversal of Quantitative Easing, which then leads to a fundamental reassessment by investors of the relative risks of holding bonds, as opposed to equities. This could lead to a

major flight from bonds to equities and a sharp increase in bond yields in the US, which could then spill over into impacting bond yields around the world.

Investment and borrowing rates

- Investment returns are likely to remain low during 2018/19 but to be on a gently rising trend over the next few years.
- Borrowing interest rates increased sharply after the result of the general election in June and then also after the September MPC meeting when financial markets reacted by accelerating their expectations for the timing of Bank Rate increases. Apart from that, there has been little general trend in rates during the current financial year. 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 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.

(End of Link Asset Services commentary)

The Council will be mindful of the above comments when formulating its borrowing strategy.