Appendix A

Treasury Management Strategy 2019-20 to 2022-23 and Prudential Indicators

The Capital Prudential Indicators 2019-20 to 2022-23
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.

Following the introduction of the new CIPFA Code of Practice and Prudential Code effective from 01/04/2018, the definition of an investment was extended to include non-financial investments. That is, assets purchased primarily for financial return. New indicators have been added (tables 7 & 8) to identify:

1. How investments are funded and the rate of return achieved
2. If borrowing has occurred to finance the investment and if so
    2.1. Debt to net service ratio
    2.2. Commercial income to net service ratio
    2.3. Investment cover ratio
    2.4. Loan to value ratio
    2.5. The opportunities and risks over the repayment period

The strategy also requires that a statement is made annually to confirm that the fair value of the non-financial investments is sufficient to provide security against loss, and if not, what mitigating actions are being taken to protect the capital invested.

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.

Table 1

Capital Expenditure £	2017-18 Actual	2018-19 Forecast*	2019-20 Estimate	2020-21 Estimate	2021-22 Estimate	2022-23 Estimate
Commercialisation	795,987	2,849,716	2,510,215	2,809,707	3,409,500	1,321,219
Strategy & Governance	428,067	271,932	1,150,000	-	-	-
Place	1,323,281	3,891,508	1,261,221	1,973,721	6,123,721	1,123,721
Capital Loans	590,557	463,376	-	-	-	-
Total	**3,137,892**	**7,476,532**	**4,921,436**	**4,783,428**	**9,533,221**	**2,444,940**

* This is in line with draft budget report to Full Council February 2019.

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 £	2017-18 Actual	2018-19 Forecast	2019-20 Estimate	2020-21 Estimate	2021-22 Estimate	2022-23 Estimate
Total	**3,137,892**	**7,476,532**	**4,921,436**	**4,783,428**	**9,533,221**	**2,444,940**
Financed by:						
Capital grants	1,244,006	2,688,937	3,182,797	1,813,428	1,203,721	1,203,721
Capital reserves	1,192,603	2,091,289	712,639	1,936,000	95,000	98,000
External Borrowing	-	-	-	-	-	-
Revenue	110,726	2,232,930	1,026,000	-	3,514,500	1,143,219
Capital Loans	590,557	463,376	-	-	-	-
Net financing need for the year	**Nil**	**Nil**	**Nil**	**1,034,000**	**4,720,000**	**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. Whilst the CFR is negative, no borrowing is required.

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 £8,278k of such schemes within the CFR.

Table 3:

£'000	2018/19 Forecast	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate
Capital Financing Requirement					
Opening CFR	(2,850)	(1,823)	(1,751)	1,034	5,754
Movement in CFR	1,027	72	2,785	4,720	(683)
Closing CFR	**(1,823)**	**(1,751)**	**1,034**	**5,754**	**5,071**

This table indicates that the Council has a borrowing need within this reporting period. This is mainly due to 2 projects which are repaid through revenue over time (waste contract vehicles and the Health Hub). This position will be re-visited in future years budget setting as the capital programme is reviewed, to measure whether internal balances are sufficient to cover these amounts for internal borrowing. The CFR will need to be monitored closely to ensure future capital expenditure remains affordable. As per the Capital strategy, any Government funding available for specific initiatives will be sought to enable projects to be self -financing.

Any decision to borrow externally 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).

Full Council is required 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	2018-19 Forecast	2019-20 Estimate	2020-21 Estimate	2021-22 Estimate	2022-23 Estimate
Earmarked reserves	12,928	13,393	15,465	14,479	11,657
Capital receipts	-	-	-	-	-
Total core funds	12,928	13,393	15,465	14,479	11,657
Working capital*	**5,000**	**5,000**	**5,000**	**5,000**	**5,000**
Expected investments	**18,370**	**18,764**	**18,051**	**12,345**	**10,206**

*Working capital balances are estimated year end; may be higher or lower during the 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

%	2019-20 Estimate	2020-21 Estimate	2021-22 Estimate	2022-23 Estimate
Non-HRA	**(0.11%)**	**(1.20%)**	**(0.19%)**	**(0.18%)**

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

The Treasury Management Strategy 2019-20 to 2022-23

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 2018, 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 6

External Debt £'000	2018-19 Forecast	2019-20 Estimate	2020-21 Estimate	2021-22 Estimate	2022-23 Estimate
Actual gross debt at 31 March	-	-	-	-	-
The Capital Financing Requirement	(1,823)	(1,751)	1,034	5,754	5,071

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 2019/20 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 and 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.

Non-Financial Investments
The value of the non-financial investments held by the Council and the yield are as follows:

Table 7

	31/3/2017	31/3/2018
Value of Investment Property *	£24,610,851	£26,392,731
Finance Leases	£9,854,372	£9,831,735
Yield	8.00%	7.30%
Average return on cash investments	0.776%	0.839%

* NB yield figures are taken from indicator BSCPIND010 on Pentana - Including finance leases. Some properties that for financial reporting purposes are categorised as Property Plant & Equipment/Surplus are part of the yield calculation.

The S151 officer confirms that the fair value of the non-financial investments is sufficient to provide security against loss. The investment properties are fully financed and no debt liability applies to these assets.

Borrowing in respect of non-financial investments
The Prudential Code states that borrowing should not take place in advance of need purely to profit from the investment of the extra sum borrowed.

This authority has not undertaken borrowing in advance of need and the following table sets out any borrowing that has taken place in respect of non-financial investments and measures the impact of such activity:

Table 8

£'000	2018-19 Forecast	2019-20 Estimate	2020-21 Estimate	2021-22 Estimate	2022-23 Estimate
Value of borrowing	-	-	-	-	-
Debt to net service ratio	-	-	-	-	-
Commercial income to net service ratio	-	-	-	-	-
Investment cover ratio	-	-	-	-	-
Loan to value ratio	-	-	-	-	-

As no borrowing has occurred, there are no opportunities and risks to report on over the repayment period.

Should the Council undertake any borrowing, the maximum exposure to borrowing costs (i.e. interest repayments and MRP) will not exceed £500,000 in aggregate at any one time

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 9

Operational boundary £'000	2018-19 Forecast	2019-20 Estimate	2020-21 Estimate	2021-22 Estimate	2022-23 Estimate
Debt	-	-	-	-	-
Other long term liabilities	8,278	8,035	7,780	7,511	7,227
Total	8,278	8,035	7,780	7,511	7,227

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 10

Authorised limit £'000	2018-19 Forecast	2019-20 Estimate	2020-21 Estimate	2021-22 Estimate	2022-23 Estimate
Debt (Bank overdraft)	250	250	250	250	250
Other long term liabilities	8,278	8,035	7,780	7,511	7,227
Total	8,528	8,285	8,030	7,761	7,477

Borrowing strategy
Forecasts show there is an underlying need to borrow from 2020-21. Borrowing will only take place after full consideration of the need for and the implications of borrowing. Short term use of cash balances will be required to fund the capital programme (internal borrowing). 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 external 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 11

£'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. Should the Council make a decision to borrow, it will consider loans offered by the Municipal Bonds Agency as well as other providers.

Prospects for interest rates (as at January 2019)
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.

Link Asset Services Interest Rate View	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%	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	0.90%	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	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	1.20%	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	2.10%	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%	2.60%	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%	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%	2.80%	2.90%	2.90%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.30%	3.40%	3.40%

The flow of generally positive economic statistics after the quarter ended 30 June 2018 meant that it came as no surprise that the MPC came to a decision on 2 August to make the first increase in Bank Rate above 0.5% since the financial crash, from 0.5% to 0.75%. Growth became increasingly strong during 2018 until slowing significantly during the last quarter. At their November quarterly Inflation Report meeting, the MPC left Bank Rate unchanged, but expressed some concern at the Chancellor's fiscal stimulus in his Budget, which could increase inflationary pressures. However, it is unlikely that the MPC would increase Bank Rate in February 2019, ahead of the deadline in March for Brexit. On a major assumption that Parliament and the EU agree a Brexit deal in the first quarter of 2019, then the next increase in Bank Rate is forecast to be in May 2019, followed by increases in February and November 2020, before ending up at 2.0% in February 2022.

The overall longer run future trend is for gilt yields, and consequently PWLB rates, to rise, albeit gently. However, over about the last 25 years, we have been through a period of falling bond yields as inflation subsided to, and then stabilised at, much lower levels than before, and supported by central banks implementing substantial quantitative easing purchases of government and other debt after the financial crash of 2008. Quantitative easing, conversely, also caused a rise in equity values as investors searched for higher returns and purchased riskier assets. In 2016, we saw the start of a reversal of this trend with a sharp rise in bond yields after the US Presidential election in November 2016, with yields then rising further as a result of the big increase in the US government deficit aimed at stimulating even stronger economic growth. That policy change also created concerns around a significant rise in inflationary pressures in an economy which was already running at remarkably low levels of unemployment. Unsurprisingly, the Fed has continued on its series of robust responses to combat its perception of rising inflationary pressures by repeatedly increasing the Fed rate to reach 2.25 – 2.50% in December 2018. It has also continued its policy of not fully reinvesting proceeds from bonds that it holds as a result of quantitative easing, when they mature. We therefore saw US 10 year bond Treasury yields rise above 3.2% during October 2018 and also investors causing a sharp fall in equity prices as they sold out of holding riskier assets. However, by early January 2019, US 10 year bond yields had fallen back considerably on fears that the Fed was being too aggressive in raising interest rates and was going to cause a recession. Equity prices have been very volatile on alternating good and bad news during this period.

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, emerging market developments and sharp changes in investor sentiment. 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.

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 while they were on a rising trend during the first half of the year, they have backtracked since then until early January. 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.
(End of Link Asset Services commentary)

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