Appendix A

Treasury Management Strategy 2021-22 to 2023-24 and Prudential Indicators

The Capital Prudential Indicators 2021-22 to 2023-24

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.

Table 1

Capital Expenditure £	2019-20 Actual	2020-21 Forecast*	2021-22 Estimate	2022-23 Estimate	2023-24 Estimate
Commercialisation	915,277	5,802,888	13,324,479	290,806	1,180,806
Strategy & Governance	1,034,664	192,500	167,500	257,500	267,500
Place	2,100,269	7,227,727	1,875,668	2,471,850	1,171850
Capital Loans	529,117	386,222	0	0	0
Total	**4,579,327**	**13,609,337**	**15,367,647**	**3,020,156**	**2,620,156**

* This is in line with draft budget report to Full Council February 2021 (as at 30/11/2020)

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 £	2019-20 Actual	2020-21 Forecast*	2021-22 Estimate	2022-23 Estimate	2023-24 Estimate
Total	**4,579,327**	**13,609,337**	**15,367,647**	**3,020,156**	**2,620,156**
Financed by:					
Capital grants	2,049,711	6,597,132	14,227,321	1,171,850	1,171,850
Capital reserves	1,260,208	330,985	1,849,184	368,630	254,534
Internal Borrowing	-				
External Borrowing	-				
Revenue	1,269,408	774,098	1,109,830	721,000	1,721,000
Capital Loans	0	-	-	-	-
Net financing need for the year	**Nil**	**3,337,000**	**1,519,000**	**978,000**	**451,000**

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 asset's 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 £7,780k of such schemes within the CFR.

Table 3:

£'000	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate
Opening CFR	5,465	11,117	9,030	8,205
Movement in CFR	(2,128)	(9,598)	(8,052)	(7,754)
Closing CFR	**3,337**	**1,519**	**978**	**451**

This table indicates that the Council has a borrowing need within this reporting period. This position will be reviewed during 21/22 to ensure internal balances are sufficient to cover these amounts from internal borrowing. The CFR and available cash 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 will 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	2020-21 Forecast	2021-22 Estimate	2022-23 Estimate	2023-24 Estimate
Earmarked reserves	10,883	10,552	10,530	9,205
Capital receipts	-	-	-	-
Total core funds	10,883	10,552	10,530	9,205
Working capital*	**5,000**	**5,000**	**5,000**	**5,000**
Expected investments	**11,500**	**9,000**	**9,000**	**9,000**

*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

%	2021-22 Estimate	2022-23 Estimate	2023-24 Estimate
Non-HRA	**(0.69%)**	**(0.85%)**	**(0.81%)**

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

The Treasury Management Strategy 2021-22 to 2023-24

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 2020, 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	2020-21 Forecast	2021-22 Estimate	2022-23 Estimate	2023-24 Estimate
Actual gross debt at 31 March	**-**	**-**	**-**	**-**
The Capital Financing Requirement	**3,337**	**1,519**	**978**	**451**

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 2021/22 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

	31/3/2019	31/3/2020
Value of Investment Property *	**£31,149,250**	**£32,013,200**
Finance Leases	**£9,802,973**	**£9,7869,226**
Yield	**7.10%**	**7.1%**
Average return on cash investments	**0.891%**	**0.892%**

* 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	**2020-21 Forecast**	**2021-22 Estimate**	**2022-23 Estimate**	**2023-24 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	2020-21 Forecast	2021-22 Estimate	2022-23 Estimate	2023-24 Estimate
Debt	-	-	-	-
Other long term liabilities	7,780	7,511	7,227	6,929
Total	7,780	7,511	7,227	6,929

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	2020-21 Forecast	2021-22 Estimate	2022-23 Estimate	2023-24 Estimate
Debt (Bank overdraft)*	2,000	2,000	2,000	2,000
Other long term liabilities	7,780	7,511	7,227	6,929
Total	9,780	9,511	9,227	8,229

An authorised overdraft of up to £2m is recommended in order to accommodate any short term cashflow issues arising from internal borrowing. However, the Council will operate an overdraft of £250k and will only action the upper limit should the need arise.

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	2019/20	2020/21	2021/22	2022/23
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.

1.1 Prospects for interest rates (as at November 2020) – Commentary from Link Asset Services

(Start of Link Asset Services Commentary)
The Council has appointed Link Group as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates.

Link Group Interest Rate View 9.11.20														
These Link forecasts have been amended for the reduction in PWLB margins by 1.0% from 26.11.20														
	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24
BANK RATE	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
3 month ave earnings	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
6 month ave earnings	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
12 month ave earnings	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20
5 yr PWLB	0.80	0.80	0.80	0.80	0.80	0.90	0.90	0.90	0.90	0.90	1.00	1.00	1.00	1.00
10 yr PWLB	1.10	1.10	1.10	1.10	1.10	1.20	1.20	1.20	1.20	1.20	1.30	1.30	1.30	1.30
25 yr PWLB	1.50	1.50	1.60	1.60	1.60	1.60	1.70	1.70	1.70	1.70	1.80	1.80	1.80	1.80
50 yr PWLB	1.30	1.30	1.40	1.40	1.40	1.40	1.50	1.50	1.50	1.50	1.60	1.60	1.60	1.60

The coronavirus outbreak has done huge economic damage to the UK and economies around the world. After the Bank of England took emergency action in March to cut Bank Rate to first 0.25%, and then to 0.10%, it left Bank Rate unchanged at its subsequent meetings to 5th November, although some forecasters had suggested that a cut into negative territory could happen. However, the Governor of the Bank of England has made it clear that he currently thinks that such a move would do more damage than good and that more quantitative easing is the favoured tool if further action becomes necessary. As shown in the forecast table above, no increase in Bank Rate is expected in the forecast table above as economic recovery is expected to be only gradual and, therefore, prolonged.

Gilt yields / PWLB rates
There was much speculation during the second half of 2019 that bond markets were in a bubble which was driving bond prices up and yields down to historically very low levels. The context for that was a heightened expectation that the US could have been heading for a recession in 2020. In addition, there were growing expectations of a downturn in world economic growth, especially due to fears around the impact of the trade war between the US and China, together with inflation generally at low levels in most countries and expected to remain subdued. Combined, these conditions were conducive to very low bond yields. While inflation targeting by the major central banks has been successful over the last thirty years in lowering inflation expectations, the real equilibrium rate for central rates has fallen considerably due to the high level of borrowing by consumers. This means that central banks do not need to raise rates as much now to have a major impact on consumer spending, inflation, etc. The consequence of this has been the gradual lowering of the overall level of interest rates and bond yields in financial markets over the last 30 years. Over the year prior to the coronavirus crisis, this has seen many bond yields up to 10 years turn negative in the Eurozone. In addition, there has, at times, been an inversion of bond yields in the US whereby 10 year yields have fallen below shorter term yields. In the past, this has been a precursor of a recession. The other side of this coin is that bond prices are elevated as investors would be expected to be moving out of riskier assets i.e. shares, in anticipation of a downturn in corporate earnings and so selling out of equities.

Gilt yields had therefore already been on a generally falling trend up until the coronavirus crisis hit western economies during March 2020. After gilt yields spiked up during the financial crisis in March, we have seen these yields fall sharply to unprecedented lows as investors panicked during March in selling shares in anticipation of impending recessions in western economies, and moved cash into safe haven assets i.e. government bonds. However, major western central banks took rapid action to deal with excessive stress in financial markets during March, and started massive quantitative easing purchases of government bonds: this also acted to put downward pressure on government bond yields at a time when there has been a huge and quick expansion of government expenditure financed by issuing government bonds. Such unprecedented levels of issuance in "normal" times would have caused bond yields to rise sharply. Gilt yields and PWLB rates have been at remarkably low rates so far during 2020/21.

As the interest forecast table for PWLB certainty rates above shows, there is expected to be little upward movement in PWLB rates over the next two years as it will take economies, including the UK, a prolonged period to recover all the momentum they have lost in the sharp recession caused during the coronavirus shut down 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, (as shown on 9th November when the first results of a successful COVID-19 vaccine trial were announced). Such volatility could occur at any time during the forecast period.

Investment and borrowing rates

- **Investment returns** are likely to remain exceptionally low during 2021/22 with little increase in the following two years.

- **Borrowing interest rates** fell to historically very low rates as a result of the COVID crisis and the quantitative easing operations of the Bank of England: indeed, gilt yields up to 6 years were negative during most of the first half of 20/21. The policy of avoiding new borrowing by running down spare cash balances has served local authorities well over the last few years. The unexpected increase of 100 bps in PWLB rates on top of the then current margin over gilt yields of 80 bps in October 2019, required an initial major rethink of local authority treasury management strategy and risk management. However, in March 2020, the Government started a consultation process for reviewing the margins over gilt rates for PWLB borrowing for different types of local authority capital expenditure. *(Please note that Link has concerns over this approach, as the fundamental principle of local authority borrowing is that borrowing is a treasury management activity and individual sums that are borrowed are not linked to specific capital projects.)* It also introduced the following rates for borrowing for different types of capital expenditure: -

    - **PWLB Standard Rate** is gilt plus 200 basis points (G+200bps)
    - **PWLB Certainty Rate** is gilt plus 180 basis points (G+180bps)
    - **PWLB HRA Standard Rate** is gilt plus 100 basis points (G+100bps)
    - **PWLB HRA Certainty Rate** is gilt plus 80bps (G+80bps)
    - **Local Infrastructure Rate** is gilt plus 60bps (G+60bps)

  - As a consequence of these increases in margins, many local authorities decided to refrain from PWLB borrowing unless it was for HRA or local infrastructure financing, until such time as the review of margins was concluded.

  - On 25.11.20, the Chancellor announced the conclusion to the review of margins over gilt yields for PWLB rates; the standard and certainty margins were reduced by 1% but a prohibition was introduced to deny access to borrowing from the PWLB for any local authority which had purchase of assets for yield in its three year capital programme. The new margins over gilt yields are as follows: -.

  - **PWLB Standard Rate** is gilt plus 100 basis points (G+100bps)
  - **PWLB Certainty Rate** is gilt plus 80 basis points (G+80bps)
  - **PWLB HRA Standard Rate** is gilt plus 100 basis points (G+100bps)
  - **PWLB HRA Certainty Rate** is gilt plus 80bps (G+80bps)

- **Local Infrastructure Rate** is gilt plus 60bps (G+60bps)

(End of Link Asset Services commentary)

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