

## Treasury Management Strategy Statement 2019/20

### Introduction

- 1 Treasury management at Surrey County 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 Authority to approve a treasury management strategy before the start of each financial year.
- 2 In addition, the Ministry of Housing, Communities and Local Government (MHCLG) issued revised Statutory Guidance on Local Government Investment in February 2018. The new requirements of the MHCLG Investment Guidance are covered in the Council's Capital and Investment Strategy, which will be considered by Council on 5 February.
- 3 This report fulfils the Authority's legal obligation under the Local Government Act 2003 to have regard to the CIPFA Code. A full set of Prudential Indicators and Treasury Indicators are set out in Annex 1.
- 4 Treasury management is the management of the Authority's cash flows, borrowing and investments, and the associated risks. The Authority has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of financial risk are therefore central to the Authority's prudent financial management.
- 5 Investments held for service purposes or for commercial profit are considered in the Capital and Investment Strategy and therefore this strategy relates solely to borrowing and investments undertaken as part of the daily treasury management activities.

### External Context

- 6 **Economic background:** The UK's progress negotiating its exit from the European Union, together with its future trading arrangements, will continue to be a major influence on the Authority's treasury management strategy for 2019/20.
- 7 The rise in quarterly GDP growth to 0.6% in Q3 from 0.4% in the previous quarter was due to weather-related factors boosting overall household consumption and construction activity over the summer following the weather-related weakness in Q1.
- 8 In November 2018, the MPC maintained Bank Rate at 0.75% while the Inflation Report showed that compared to the August report further interest rate increases may be required to bring inflation down to the 2% target over the forecast horizon.
- 9 UK Consumer Price Inflation (CPI) for November was up 2.3% year/year, broadly in line with the Bank of England's November Inflation Report.
- 10 **Credit outlook:** The big four UK banking groups have now divided their retail and investment banking divisions into separate legal entities under ringfencing legislation. Bank

of Scotland, Barclays Bank UK, HSBC UK Bank, Lloyds Bank, National Westminster Bank, Royal Bank of Scotland and Ulster Bank are the ringfenced banks that now only conduct lower risk retail banking activities. Barclays Bank, HSBC Bank, Lloyds Bank Corporate Markets and NatWest Markets are the investment banks. Credit rating agencies have adjusted the ratings of some of these banks with the ringfenced banks generally being better rated than their non-ringfenced counterparts.

**Interest rate forecast:**

- 11 Following the increase in Bank Rate to 0.75% in August 2018, the Authority’s treasury management adviser Arlingclose is forecasting two more 0.25% hikes during 2019 to take official UK interest rates to 1.25% by the end of the year. The Bank of England’s MPC has maintained expectations for slow and steady rate rises over the forecast horizon.
- 12 Gilt yields and hence long-term borrowing rates have remained at low levels but some upward movement from current levels is expected.
- 13 A more detailed economic and interest rate forecast provided by Arlingclose is attached at **Annex 2**.
- 14 For the purpose of setting the budget for 2019/20, it has been assumed that new investments will be made at an average rate of 0.75%, and that new short-term loans will be borrowed at an average rate of 1.0%

**Local Context:**

- 15 On 31 December 2018 the Authority held £711m of short and long-term borrowing and £17m of investments. This is set out in further detail in **Annex 3**.
- 16 The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. The Authority’s current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing. Internal borrowing allows the Council to utilise its internal cash balances (i.e. working capital and reserves) which are not required in the short to medium term in order to reduce risk and keep interest costs low.
- 17 Forecast changes in these sums are shown in the balance sheet analysis in Table 1 below.

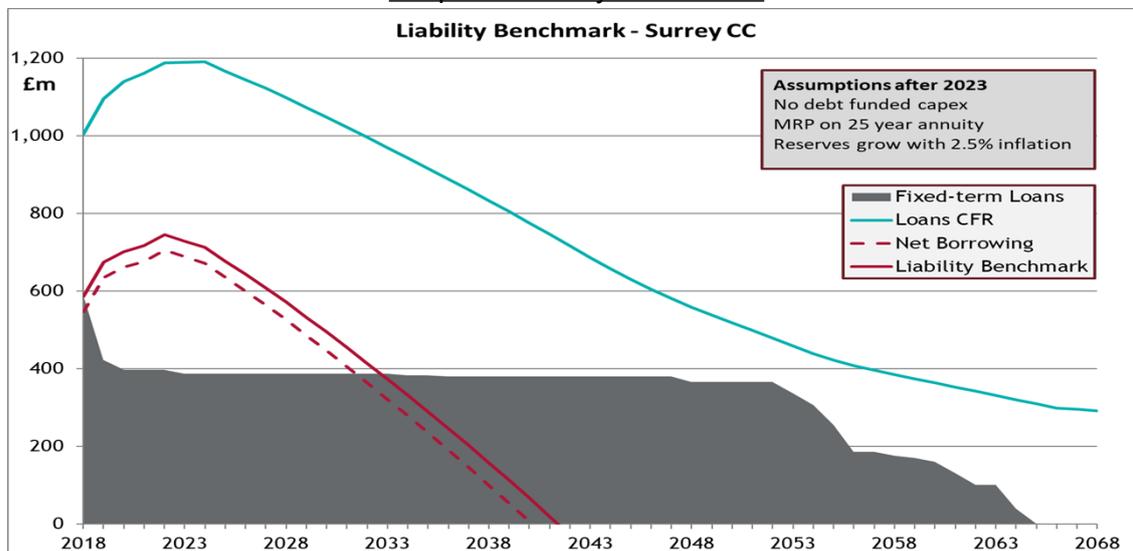
Table 1: Balance sheet summary and forecast

	<b>31.3.18 Actual £m</b>	<b>31.3.19 Estimate £m</b>	<b>31.3.20 Forecast £m</b>	<b>31.3.21 Forecast £m</b>	<b>31.3.22 Forecast £m</b>	<b>31.3.23 Forecast £m</b>	<b>31.3.24 Forecast £m</b>
General Fund CFR	1,152	1,267	1,303	1,317	1,337	1,332	1,325
Less: PFI liabilities	-181	-205	-198	-191	-184	-176	-168
<b>Net CFR (underlying need to borrow)</b>	<b>971</b>	<b>1,062</b>	<b>1,105</b>	<b>1,126</b>	<b>1,153</b>	<b>1,156</b>	<b>1,157</b>
Less: External	-397	-397	-397	-397	-397	-387	-387

borrowing (long term)							
Internal borrowing (based on projection of level of reserves, balances and working capital)	-381	-346	-373	-367	-400	-413	-422
<b>Projected additional external borrowing requirement</b>	<b>193</b>	<b>292</b>	<b>319</b>	<b>335</b>	<b>362</b>	<b>356</b>	<b>348</b>

- 17 The Authority has an increasing CFR over the period to 31 March 2022, due to the proposed capital programme and approved investment strategy projects. The maximisation of internal borrowing leads to a borrowing requirement above the Council’s ability to utilise its internal resources to fund this capital expenditure. It will therefore be required to raise additional external borrowing over the forecast period.
- 18 CIPFA’s Prudential Code for Capital Finance in Local Authorities recommends that the Authority’s total debt should be lower than its highest forecast CFR over the next three years. Table 1 shows that the Authority expects to comply with this recommendation during 2019/20.
- 19 To compare the Council’s actual borrowing against an alternative strategy, a liability benchmark has been calculated showing the Council’s projected treasury management position over the next 50 years.

Graph 1: Liability benchmark



20 The long-term liability benchmark assumes:

- Capital expenditure funded by borrowing as per the 2019/24 capital programme
- Only projects approved and included in the Capital Programme and approved investment strategy spend are currently included
- Minimum Revenue Provision (MRP) on new capital expenditure is based on the existing MRP policy
- Reserves and Balances are based on proposed and approved use over the life of the MTFP and increasing by inflation of 2.5% a year.

- 21 As illustrated in the graph above, the difference between the CFR (underlying need to borrow) and actual external borrowing is funded from Reserves and Balances (internal borrowing). The current strategy to internally borrow continues to support the Council's financial position in the short to medium term.
- 22 As shown, the Council's current debt portfolio is long dated and there are no significant repayments until the 2050's.

### **Borrowing Strategy**

- 23 The Authority is projected to have £688m of borrowing as at the end of March 2019, an increase of £80m since the 31 March 2018. The increase relates to short term borrowing, which changes to reflect the changing cash flow requirements. Financial year end is historically the low point for cash levels, with government grants received early in the financial year, ahead of spend. Long term borrowing remains at £397m. There is no change from the previous year, as no additional long term borrowing has been undertaken or repaid.
- 24 **Objectives:** The Authority's main objective when borrowing money is to strike an appropriate balance between securing low interest costs and achieving certainty of those costs over the period for which funds are required.
- 25 **Strategy:** The Council is facing unprecedented financial pressures, principally driven by rising need for services from residents and continuing reductions in government funding. Given these pressures, the Authority's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. With short-term interest rates currently much lower than long-term rates, the Authority continues to maximise the use of internal resources (internal borrowing) and borrowing short term to fund the additional requirement based on cash flow forecasts.
- 26 By doing so, the Authority is able to reduce net borrowing costs (despite foregone investment income) and reduce market and credit risk in the investment portfolio. However, short term borrowing does increase the Authority's exposure to changes in interest rates as when short term loans mature they may need to be replaced and a higher rate of interest. The level of internal / short term borrowing will be reviewed on a regular basis, taking account of the overall cash position and market forecasts. Arlingclose will assist in this review with 'cost of carry' and breakeven analysis, which will support decisions on whether to take additional longer term external borrowing at fixed rates in 2019/20, with a view to keeping future interest costs low.
- 27 Alternatively, the Authority may arrange forward starting loans where the interest rate is fixed in advance, but the cash is received in later years. This would enable certainty of cost without suffering a cost of carry in the intervening period.
- 28 **Sources of borrowing:** The approved sources of long-term and short-term borrowing are:
- Public Works Loan Board (PWLB) and any successor body
  - any institution approved for investments (see below)

- banks or building societies authorised to operate in the UK
- UK local authorities
- UK public and private sector pension funds (except the Surrey Pension Fund)
- capital market bond investors
- UK Municipal Bonds Agency plc and other special purpose companies created to enable local authority bond issues.

29 The Authority has previously raised the majority of its long term borrowing from the PWLB. For short term borrowing, the Council has, and will continue, to use other sources of finance, such as loans from other local authorities, pension funds and other public bodies as these are often available at more favourable rates. These short term loans leave the Authority exposed to the risk of interest rate rises and are therefore subject to the interest rate exposure limits in the treasury management indicators below.

30 **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 (PFI)
- sale and leaseback

All such sources of finance are subject to a robust options appraisal.

31 **Municipal Bonds Agency:** UK Municipal Bonds Agency plc was established in 2014 by the Local Government Association as an alternative to the PWLB. It plans to issue bonds on the capital markets and lend the proceeds to local authorities. This will be a more complicated source of finance than the PWLB for two reasons: borrowing authorities will be required to provide bond investors with a joint and several guarantee to refund their investment in the event that the agency is unable to for any reason; and there will be a lead time of several months between committing to borrow and knowing the interest rate payable. Any decision to borrow from the Agency will therefore be the subject of a separate report.

32 **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. Other lenders may also be prepared to negotiate premature redemption terms. The Authority 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.

## Investment Strategy

33 The Authority holds invested funds representing income received in advance of expenditure plus reserves. Since 1 April 2018, the Authority held average balances of £39m, compared to with £69m over 2017/18. The average returns of 0.58%. Cash balances are expected to remain low during 2019/20.

- 34 **Objectives:** The CIPFA Code requires the Authority to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Authority’s objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income. Where balances are expected to be invested for more than one year, the Authority will aim to achieve a total return that is equal or higher than the prevailing rate of inflation, in order to maintain the spending power of the sum invested.
- 35 **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. 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.
- 36 **Strategy:** Due to the continuation of the strategy to maximise internal borrowing and use short term borrowing to manage cash flow shortfalls, investment levels are expected to remain low during 2018/19. The majority of the Authority’s surplus cash continues to be invested in money market funds and short-term unsecured bank deposits. Money Market Funds offer same-day liquidity, very low or no volatility and also ensure diversification to reduce the security risk of holding the majority of cash deposits with a limited number of UK banks.
- 37 While the Council’s investment balances remain low (less than £100m), Money Market Funds and short term bank deposits will be utilised, with a cash limit per counterparty/fund of £25m. If the economic situation changes, which results in a decision to undertake additional borrowing, resulting in higher cash balances, other investment counterparties may be considered and the counterparty limits set out below would apply.
- 38 **Business models:** Under the new International Financial Reporting Standard (IFRS) 9 standard, the accounting for certain investments depends on the Authority’s “business model” for managing them. The new standard requires entities to account for expected credit losses in a timely manner; from the moment when financial instruments are first identified. These investments will continue to be accounted for at amortised cost.
- 39 **Approved counterparties:** The Authority may invest its surplus funds with any of the counterparty types in Table 2 below, subject to the cash limits (per counterparty) and the time limits shown.

40 Table 2: Approved investment counterparties and limits

<b>Credit rating</b>	<b>Banks unsecured</b>	<b>Banks secured</b>	<b>Government*</b>
UK Govt	n/a	n/a	£ Unlimited 50 years
AAA	£10m 5 years	£20m 20 years	n/a
AA+	£10m 5 years	£20m 10 years	n/a
AA	£10m 4 years	£20m 5 years	n/a
AA-	£10m 3 years	£20m 4 years	n/a
A+	£10m 2 years	£20m 3 years	n/a
A	£10m 13 months	£20m 2 years	n/a
A-	£10m 6 months	£20m 13 months	n/a
None	£1m 6 months	n/a	<b>n/a</b>
Pooled Funds	£25m per fund		

\* UK local authorities

This table must be read in conjunction with the notes below

- 41 **Credit rating:** Investment limits are set by reference to the lowest published long-term credit rating from Fitch, Moody's and Standard & Poor's. Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used. However, investment decisions are never made solely based on credit ratings, and all other relevant factors including external advice will be taken into account.
- 42 **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.
- 43 **Banks secured:** Covered bonds, reverse repurchase agreements and other collateralised arrangements with banks and 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.

- 44 **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, although they are not zero risk. Investments with the UK Central Government may be made in unlimited amounts for up to 50 years.
- 45 **Pooled funds:** Shares or units in diversified investment vehicles consisting of the 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 as an alternative to instant access bank accounts, while pooled funds whose value changes with market prices and/or have a notice period will be used for longer investment periods.
- 46 Bond, equity and property funds offer enhanced returns over the longer term, but are more volatile in the short term. These allow the Authority to diversify into asset classes other than cash without the need to own and manage the underlying investments. Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Authority's investment objectives will be monitored regularly.
- 47 **Operational bank accounts:** The Authority may incur operational exposures, for example through current accounts, collection accounts and merchant acquiring services, to any UK bank with credit ratings no lower than BBB- and with assets greater than £25 billion. These are not classed as investments, but are still subject to the risk of a bank bail-in, and balances will therefore be kept below £1m. The Bank of England has stated that in the event of failure, banks with assets greater than £25 billion are more likely to be bailed-in than made insolvent, increasing the chance of the Authority maintaining operational continuity. The Authority's bank, HSBC, has a credit rating of AA-.
- 48 **Risk assessment and credit ratings:** Credit ratings are obtained and monitored by the Authority's treasury advisers, 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 the recall or sale of all other existing investments with the affected counterparty.
- 49 Where a credit rating agency announces that a credit rating is on review for possible downgrade (also known as "rating watch negative" or "credit watch negative") so that it may fall below the approved rating criteria, then only investments that can be withdrawn on the next working day will be made with 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.

- 50 **Other information on the security of investments:** The Authority 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. No investments will be made with an organisation if there are substantive doubts about its credit quality.
- 51 When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008 and 2011, this is not generally reflected in credit ratings, but can be seen in other market measures. In these circumstances, the Authority 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 Authority’s cash balances, then the surplus will be deposited with the UK Government via the Debt Management Office or invested in government treasury bills or with other local authorities. This will cause a reduction in the level of investment income earned, but will protect the principal sum invested. In the event of a “no deal Brexit”, the Authority has the ability to invest in UK based MMFs (Federated and CCLA) and with the Debt Management Officer (DMO), which is in effect a direct investment with the UK Government.
- 52 **Investment limits:** The Authority’s revenue reserves and balances available to cover investment losses are forecast to be approximately £65m on 31<sup>st</sup> March 2019. In order that no more than 30% of available reserves will be put at risk in the case of a single default, the maximum that will be invested with any one organisation (other than the UK Government) will be £20m and the limit for any one pooled fund will be £25m.

Table 3: Investment limits

	<b>Cash limit</b>
Any single organisation, except the UK Central Government	£20m each
UK Central Government	unlimited
Any group of organisations under the same ownership	£20m per group
Any group of pooled funds under the same management	£25m per manager
Money Market Funds	£125m in total
Unsecured investments with Building Societies	10m in total

- 53 **Liquidity management:** The Authority uses cash flow forecasting 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 Authority being forced to borrow on unfavourable terms to meet its financial commitments. Limits on long-term investments are set by reference to the Authority’s medium-term financial plan and cash flow forecast.

## Treasury Management Indicators

54 The Authority measures and manages its exposures to treasury management risks using the following indicators.

55 **Security:** The Authority has adopted a voluntary measure of exposure to credit risk by monitoring the value-weighted average default rates of its investment portfolio. This is calculated by taking the historic risk of default rate, weighted by the size of each investment and calculating a portfolio average. Unrated investments are assigned a score based on their perceived risk.

	Maximum Exposure
Portfolio average historic risk of default rate	0.05%

56 **Liquidity:** The Authority has adopted a voluntary measure of exposure to liquidity risk by monitoring the amount it can borrow over an average month without giving prior notice. During December 2018, a total of £180m was sourced from other local authorities for short term periods. During 2018 the Council has never been overdrawn due to a failure to find funding. The intra local authority borrowing/lending market has remained a reliable source of short term funding, and should remain so for the foreseeable future.

57 **Interest rate exposures:** This indicator is set to limit the Authority's exposure to interest rate risk by assessing the impact of a 1% rise or fall in interest rates will be, based upon an average short term borrowing of £195m.

Interest rate risk indicator	Limit
Revenue impact of a 1% movement in interest rates	+/- £1.95m

The impact of a change in interest rates is calculated on the assumption that maturing loans and investments will be replaced at current rates.

58 **Maturity structure of borrowing:** This indicator is set to control the Authority's exposure to refinancing risk. The upper and lower limits on the maturity structure of borrowing will be:

Refinancing rate risk indicator	Upper limit	Lower limit
Under 12 months	60%	0%
12 months and within 24 months	50%	0%
24 months and within 5 years	50%	0%
5 years and within 10 years	75%	0%
10 years and above	100%	25%

59 Time periods start on the first day of each financial year. The maturity date of borrowing is the date of the loans are due to be repaid.

60 **Principal sums invested for periods longer than 1 year:** The purpose of this indicator is to control the Authority's exposure to the risk of incurring losses by seeking early repayment

of its investments. The limits on the long-term principal sum invested to final maturities beyond the period end will be:

Price risk indicator	2019/20	2020/21	2021/22
Limit on principal invested beyond year end	£40m	£20m	£10m

### Other Items

- 61 There are a number of additional items that the Authority is obliged by CIPFA of the MHCLG to include in its treasury management strategy.
- 62 **Policy on the use of Financial Derivatives:** Local authorities have previously made use of financial derivatives embedded into loans and investments both to reduce interest rate risk (e.g. interest rate collars and forward deals) and to reduce costs or increase income at the expense of greater risk (e.g. LOBO loans and callable deposits). The general power of competence in Section 1 of the *Localism Act 2011* removes much of the uncertainty over local authorities' use of standalone financial derivatives (i.e. those that are not embedded into a loan or investment).
- 63 The Authority 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 Authority 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.
- 64 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.
- 65 **Markets in Financial Instruments Directive:** The Authority has opted up to professional client status with its providers of financial services, including advisers, banks, brokers and fund managers, allowing it 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 Authority's treasury management activities, the Section 151 Officer believes this to be the most appropriate status.
- 66 **Treasury Management Advice:** Surrey County Council has appointed Arlingclose Limited as Treasury management advisers and receives specific advice on investments, debt and capital finance matters.

67 **Treasury Management Training:** Member and Officer training needs are assessed regularly as part of the staff appraisal process. Additional training will be provided as and when there is a change in roles and responsibilities. The Authority also benefits from the Orbis partnership Centre of Expertise, which provides a robust Treasury team providing day to day treasury management operational activities to Surrey County Council, Brighton & Hove City Council and East Sussex County Council.

**Financial Implications**

65 The budget for investment income in 2019/20 is £300,000, based on an average investment portfolio of £40m at an interest rate of 0.75%. The budget for debt interest paid in 2019/20 is £19m, which is based on a mix of short term borrowing (average level of £260m at an average interest rate of 1%) and the existing long term fixed rate debt portfolio.

66 The CIPFA Code does not prescribe any particular treasury management strategy for local authorities to adopt. The Section 151 Officer believes that the above strategy represents an appropriate balance between risk management and cost effectiveness. Some alternative strategies, with their financial and risk management implications, are listed below.

<b>Alternative</b>	<b>Impact on income and expenditure</b>	<b>Impact on risk management</b>
Borrow additional sums at long-term fixed interest rates	Debt interest costs will rise; this is unlikely to be offset by higher investment income	Higher investment balance leading to a higher impact in the event of a default; however long-term interest costs may be more certain
Invest in a wider range of counterparties and/or for longer times	Interest income will be higher	Increased risk of losses from credit related defaults, but any such losses may be smaller

### Prudential and Treasury Indicators 2019/20

1. The Local Government Act 2003 requires the Authority to have regard to the Chartered Institute of Public Finance and Accountancy's Prudential Code for Capital Finance in Local Authorities (the Prudential Code) when determining how much money it can afford to borrow. The objectives of the Prudential Code are to ensure, within a clear framework, that the capital investment plans of local authorities are affordable, prudent and sustainable, and that treasury management decisions are taken in accordance with good professional practice. To demonstrate that the Authority has fulfilled these objectives, the Prudential Code sets out the following indicators that must be set and monitored each year.
2. The Council has adopted the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice.

#### Estimates of capital expenditure

3. The Authority's planned capital expenditure and financing is summarised in table 1. This prudential indicator is a summary of the Council's annual capital expenditure plans, both those agreed previously, and those forming part of this budget cycle.

	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24
	Actual	Projected	← ----- Estimated ----- →				
	£m	£m	£m	£m	£m	£m	£m
Capital programme expenditure	108	137	129	93	76	58	57
Approved investment strategy spend	103	113	13	7	15	0	0
Financed By:							
- Government grants	98	84	67	50	32	32	32
- Revenue, reserves & third party contributions	1	32	17	12	12	3	3
<b>Net financing need for the year*</b>	<b>112</b>	<b>135</b>	<b>59</b>	<b>38</b>	<b>46</b>	<b>22</b>	<b>21</b>

\*Capital expenditure to be met by borrowing

#### The Council's borrowing need (the capital financing requirement)

4. Table 2 sets out the Council's estimated capital financing requirement (CFR). The CFR represents capital expenditure funded by external debt and internal borrowing and not by capital receipts, revenue contributions, capital grants or third party contributions at the time of spending. The CFR thus measures an authority's underlying need to borrow for a capital purpose. Any capital expenditure which has not been funded from locally determined resources will increase the CFR. The CFR will reduce by the minimum revenue provision (MRP).
5. The MRP is a statutory annual revenue charge which reduces the borrowing need in a similar way to paying principal off a household mortgage.
6. 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 and they therefore do not form part of the Council's underlying need to borrow.

	<b>2017/18</b>	<b>2018/19</b>	<b>2019/20</b>	<b>2020/21</b>	<b>2021/22</b>	<b>2022/23</b>	<b>2023/24</b>
	<b>Actual</b>	<b>Projected</b>	<b>← -----</b>	<b>-----</b>	<b>Estimated</b>	<b>-----</b>	<b>→</b>
	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>
Opening CFR	1,061	1,152	1,267	1,303	1,317	1,337	1,332
Movements:							
- Minimum revenue provision	-24	-21	-21	-23	-25	-26	-27
- Application of capital receipts	-28	-29	0	0	0	0	0
- PFI & finance leases	32	30	-1	-1	-1	-1	-1
- Net financing need	112	135	59	38	46	22	21
	91	115	37	14	20	-5	-7
Closing CFR	<b>1,152</b>	<b>1,267</b>	<b>1,303</b>	<b>1,317</b>	<b>1,337</b>	<b>1,332</b>	<b>1,325</b>

\*includes the addition to fixed assets on the balance sheet under PFI

7. The CFR is forecast to rise over the next 3 years, as capital expenditure plans financed by borrowing outweighs the resources planned to be set aside for debt repayment (MRP).

### **Gross borrowing and the capital financing requirement**

8. In order to ensure that over the medium term borrowing will only be for a capital purpose, the Council should ensure that its 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 the current and next 2 financial years. This allows some flexibility for early borrowing in advance of need, but ensures that borrowing is not undertaken for revenue purposes. This is a key indicator of prudence.

	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24
	Actual	Projected	← ----- Estimated ----- →				
	£m	£m	£m	£m	£m	£m	£m
Gross Borrowing	590	689	716	732	759	743	736
CFR	1,152	1,267	1,303	1,317	1,337	1,332	1,325

9. Total debt is expected to remain below the CFR during the forecast period.

### **The Council's operational boundary for external debt**

10. Table 4 sets out the Council's operational boundary. The operational boundary is an indicator against which to monitor its external debt position. It is based on the Authority's estimate of the most likely (ie prudent but not worst case) scenario for external debt. It links directly to the Authority's estimates of capital expenditure, the CFR and cash flow requirements and is a key management tool for in-year monitoring.
11. Within the operational boundary, figures for borrowing and other long-term liabilities are separately identified. Other long-term liabilities comprise finance lease, PFIs and other liabilities that are not borrowing but form part of the Authority's debt position.
12. The operational boundary is not a limit and actual borrowing could vary around this boundary for short periods during the year. It should act as an indicator to ensure the authorised limit is not breached.

	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24
	Agreed	← ----- Estimated ----- →				
	£m	£m	£m	£m	£m	£m
Borrowing	702	966	1131	1179	1173	1166
Other long term liabilities	170	143	124	106	87	68
<b>Total</b>	<b>872</b>	<b>1108</b>	<b>1256</b>	<b>1285</b>	<b>1260</b>	<b>1234</b>
Estimated external debt	689	716	732	759	743	736

### The Council's authorised limit for external debt

13. Table 5 sets out the Council's authorised limit for external debt. This key prudential indicator represents a control on the maximum level of borrowing. It is a statutory limit determined under section 3(1) of the Local Government Act 2003 and represents a limit beyond which external debt is prohibited. It is the maximum amount of debt that the Authority can legally owe.
14. 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 since the introduction of the Prudential Code.
15. The Authorised limit provides headroom over and above the operational boundary for unusual cash movements and potential additional borrowing to meet the ambitions of the Council in respect of its investment strategy.
16. As with the operational boundary, the limit separately identifies borrowing from other long term liabilities such as finance leases and PFIs.

	<b>2018/19</b>	<b>2019/20</b>	<b>2020/21</b>	<b>2021/22</b>	<b>2022/23</b>	<b>2023/24</b>
	<b>Agreed</b>	<b>← -----</b>	<b>Estimated</b>	<b>-----</b>	<b>-----</b>	<b>→</b>
	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>
Borrowing	1,092	1,553	1,717	1,757	1,762	1,755
Other long term liabilities	182	143	124	106	87	68
<b>Total</b>	<b>1274</b>	<b>1696</b>	<b>1841</b>	<b>1863</b>	<b>1849</b>	<b>1823</b>
Estimated external debt	689	716	732	759	743	736

## Estimated ratio of financing costs to net revenue stream

17. This is an indicator of affordability and highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet financing costs, net of investment income.

<b>Table 6: Ratio of Financing Costs to Net Revenue Stream</b>						
	2018/19 Projected	2019/20 ← -----	2020/21 -----	2021/22 Estimated	2022/23 -----	2023/24 ----- →
Ratio of Financing Costs to Net Revenue Stream	2.02%	1.55%	1.75%	1.89%	2.02%	2.07%

18. The revenue implications of potential, yet to be identified, investment opportunities that meet the Council's long term capital strategy criteria, will be funded from the investment returns of such investments. If there is a delay in the realisation of sufficient returns then costs will be funded from the Council's Revolving Infrastructure & Investment Fund.

### **Treasury Indicators:**

Principal sums invested for periods longer than a year (including shares, which is the only remaining limit for non-specified investment)

<b>Price risk indicator</b>	<b>2019/20</b>	<b>2020/21</b>	<b>2021/22</b>
Limit on principal invested beyond year end	£40m	£20m	£10m

Refinancing risk - Maturity structure of borrowing

<b>Refinancing rate risk indicator</b>	<b>Upper limit</b>	<b>Lower limit</b>
Under 12 months	60%	0%
12 months and within 24 months	50%	0%
24 months and within 5 years	50%	0%
5 years and within 10 years	75%	0%
10 years and above	100%	25%

Interest rate risk.

<b>Interest rate risk indicator</b>	<b>Limit</b>
Upper limit on one-year revenue impact of a 1% <u>rise</u> in interest rates	£1,95m
Upper limit on one-year revenue impact of a 1% <u>fall</u> in interest rates	-£1.95m

Portfolio average credit rating or credit score.

	<b>Maximum Exposure</b>
Portfolio average historic risk of default rate	0.05%

Liquidity

<b>Liquidity risk indicator</b>	<b>Target</b>
Total sum required in December without prior notice	£180m
Total sum borrowed in December	£180m

## Arlingclose Economic & Interest Rate Forecast December 2018

### Underlying assumptions:

- Our central interest rate forecasts are predicated on there being a transitional period following the UK's official exit from the EU.
- 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 that: 1) tight labour markets will prompt inflationary pressure in the future, 2) ultra-low interest rates result in other economic problems, and 3) higher Bank Rate will be a more effective policy weapon if downside risks to growth crystallise.
- Both our projected outlook and the increase in the magnitude of political and economic risks facing the UK economy means we maintain the significant downside risks to our forecasts, despite the potential for slightly stronger growth next year as business investment rebounds should the EU Withdrawal Agreement be approved. The potential for severe economic outcomes has increased following the poor reception of the Withdrawal Agreement by MPs. We expect the Bank of England to hold at or reduce interest rates from current levels if Brexit risks materialise.
- The UK economic environment is relatively soft, despite seemingly strong labour market data. GDP growth recovered somewhat in the middle quarters of 2018, but more recent data suggests the economy slowed markedly in Q4. 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 are easing but inflation is forecast to remain above the Bank's 2% target through most of the forecast period. Lower oil prices have reduced inflationary pressure, but the tight labour market and decline in the value of sterling means inflation may remain above target for longer than expected.
- Global economic growth is slowing. Despite slower growth, the European Central Bank is conditioning markets for the end of QE, the timing of the first rate hike (2019) and their path thereafter. More recent US data has placed pressure on the Federal Reserve to reduce the pace of monetary tightening – previous hikes and heightened expectations will, however, 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, but recent events around Brexit have dampened interest rate expectations. Our central case is for Bank Rate to rise twice in 2019, after the UK exits the EU. 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 central case that the UK will enter a transitional period following its EU exit in March 2019. However, our projected weak economic outlook and volatility arising from both economic and political events will continue to offer borrowing opportunities.

	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Average
<b>Official Bank Rate</b>														
Upside risk	0.00	0.00	0.00	0.00	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.17
<b>Arlingclose Central Case</b>	<b>0.75</b>	<b>1.00</b>	<b>1.00</b>	<b>1.25</b>	<b>1.17</b>									
Downside risk	0.00	0.50	0.50	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.65
<b>3-mth money market rate</b>														
Upside risk	0.10	0.10	0.10	0.10	0.15	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.17
<b>Arlingclose Central Case</b>	<b>0.80</b>	<b>1.00</b>	<b>1.10</b>	<b>1.20</b>	<b>1.30</b>	<b>1.30</b>	<b>1.25</b>	<b>1.20</b>	<b>1.20</b>	<b>1.20</b>	<b>1.20</b>	<b>1.20</b>	<b>1.20</b>	<b>1.17</b>
Downside risk	0.20	0.50	0.60	0.70	0.80	0.80	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.68
<b>1-yr money market rate</b>														
Upside risk	0.20	0.30	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.33
<b>Arlingclose Central Case</b>	<b>1.05</b>	<b>1.25</b>	<b>1.35</b>	<b>1.40</b>	<b>1.50</b>	<b>1.45</b>	<b>1.40</b>	<b>1.37</b>						
Downside risk	0.35	0.50	0.60	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.69
<b>5-yr gilt yield</b>														
Upside risk	0.15	0.20	0.25	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.32
<b>Arlingclose Central Case</b>	<b>1.15</b>	<b>1.20</b>	<b>1.25</b>	<b>1.35</b>	<b>1.40</b>	<b>1.40</b>	<b>1.35</b>	<b>1.35</b>	<b>1.30</b>	<b>1.30</b>	<b>1.30</b>	<b>1.30</b>	<b>1.30</b>	<b>1.30</b>
Downside risk	0.30	0.35	0.45	0.50	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.54
<b>10-yr gilt yield</b>														
Upside risk	0.20	0.25	0.25	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.32
<b>Arlingclose Central Case</b>	<b>1.60</b>	<b>1.65</b>	<b>1.65</b>	<b>1.70</b>	<b>1.75</b>	<b>1.75</b>	<b>1.75</b>	<b>1.70</b>						
Downside risk	0.30	0.45	0.50	0.55	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.55
<b>20-yr gilt yield</b>														
Upside risk	0.20	0.25	0.25	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.32
<b>Arlingclose Central Case</b>	<b>1.90</b>	<b>1.95</b>	<b>1.95</b>	<b>2.00</b>	<b>1.98</b>									
Downside risk	0.30	0.40	0.45	0.45	0.45	0.45	0.45	0.45	0.45	0.45	0.45	0.45	0.45	0.43
<b>50-yr gilt yield</b>														
Upside risk	0.20	0.25	0.25	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.32
<b>Arlingclose Central Case</b>	<b>1.80</b>	<b>1.85</b>	<b>1.85</b>	<b>1.90</b>	<b>1.88</b>									
Downside risk	0.30	0.40	0.45	0.45	0.45	0.45	0.45	0.45	0.45	0.45	0.45	0.45	0.45	0.43

PWLB Certainty Rate (Maturity Loans) = Gilt yield + 0.80%

PWLB Local Infrastructure Rate (Maturity Loans) = Gilt yield + 0.60%

## Investment &amp; Debt Portfolio Position as at 31 March 2018

	<b>Actual Portfolio £m</b>	<b>Average Rate %</b>
<b>External borrowing:</b>		
Public Works Loan Board	388	4.60
Market	10	5.00
Local authorities	211	0.48
<b>Total external borrowing</b>	<b>608</b>	
<b>Other long-term liabilities:</b>		
Private Finance Initiative	181	
<b>Total other long-term liabilities</b>	<b>181</b>	
<b>Total gross external debt</b>	<b>687</b>	
<b>Treasury investments:</b>		
Banks & building societies (unsecured)	-	
Government (incl. local authorities)	-	
Money Market Funds	43	0.21
<b>Total treasury investments</b>	<b>43</b>	
<b>Net debt</b>	<b>644</b>	

**Glossary of Terms**

**CCLA – Churches, Charities and Local Authorities**

**CFR – Capital Financing Requirement**

**CIPFA – Chartered Institute of Public Finance Accountancy**

**CPI – Consumer Price Index**

**DMO – Debt Management Office**

**DMADF – Debt Management Account Deposit Facility**

**ECB – European Central Bank**

**GDP – Gross Domestic Product**

**MHCLG – Ministry of Housing, Communities and Local Government**

**MiFID - Markets in Financial Instruments Directive**

**MMF – Money Market Fund**

**MPC – Monetary Policy Committee**

**MRP – Minimum Revenue Provision**

**PWLB – Public Works Loan Board**

**TMPs – Treasury Management Practices**

**TMPS – Treasury Management Policy Statement**

**TMSS – Treasury Management Strategy Statement**