Treasury Management Strategy Statement 2020/21

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 Council 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 4th February.

3. This report fulfils the Council'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 Council's cash flows, borrowing and investments, and the associated risks. The Council 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 Council's prudent financial management.

5. Investments held for service purposes or for commercial profit are considered in the Capital and Investment Strategies and therefore this strategy relates solely to borrowing and investments undertaken as part of the daily treasury management activities.

6. Managing the cost of the Council's borrowing is at the heart of the strategy and we work proactively with our Treasury Management advisor, Arlingclose, to ensure that our approach represents the best balance between minimising cost and managing the risk of interest rate changes. Our strategy is under constant review throughout the year.

External Context

7. **Economic background:** 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 Council's treasury management strategy for 2020/21. The General Election has removed some uncertainty within the market, however following the expected Withdrawal Bill, uncertainties around the future trading relationship with the EU remain.

8. **Interest rate forecast**: The Council's treasury management adviser Arlingclose is forecasting that Bank Rate will remain at 0.75% until the end of 2022. The risks to this forecast are deemed to be significantly weighted to the downside, particularly given the need for greater clarity on post-Brexit trade arrangements and the continuing global economic slowdown.

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9. Gilt yields have risen but remain at low levels and only some very modest upward movement from current levels are expected based on Arlingclose's interest rate projections. The central case is for 10-year and 20-year gilt yields to rise to around 1.00% and 1.40% respectively over the time horizon, with broadly balanced risks to both the upside and downside. However, short-term volatility arising from both economic and political events over the period is a near certainty. A more detailed economic and interest rate forecast provided by Arlingclose is attached at Appendix A.

10. For the purpose of setting the budget, it has been assumed that new treasury management investments will be made at an average rate of 1%, and that new long-term loans will be borrowed at an average rate of 3%.

Local Context:

11. On 31 March 2019 the Council held £676m of short and long-term borrowing and £31m of investments. By 31st December 2019, this changed slightly to £674m of borrowing and £11m of investments. 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 Council'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. Forecast changes in these sums are shown in the balance sheet analysis in Table 1 below.

Table 1 - Balance sheet summary and forecast

	31.3.19 Actual £m	**31.3.20 Estimate £m**	**31.3.21 Forecast £m**	**31.3.22 Forecast £m**	**31.3.23 Forecast £m**	**31.3.24 Forecast £m**	**31.3.25 Forecast £m**
General Fund CFR	1,217	1,269	1,422	1,598	1,816	1,985	2,074
Less: PFI and lease liabilities	(132)	(114)	(136)	(119)	(98)	(80)	(58)
Net CFR (underlying need to borrow)	**1,085**	**1,155**	**1,286**	**1,479**	**1,718**	**1,905**	**2,016**
Less: External borrowing (long term)	(397)	(437)	(436)	(433)	(420)	(417)	(414)
Internal borrowing (based on projected reserves, balances and working capital)	(409)	(429)	(449)	(441)	(440)	(447)	(454)
Projected additional external borrowing requirement	**278**	**289**	**401**	**605**	**858**	**1,041**	**1,148**

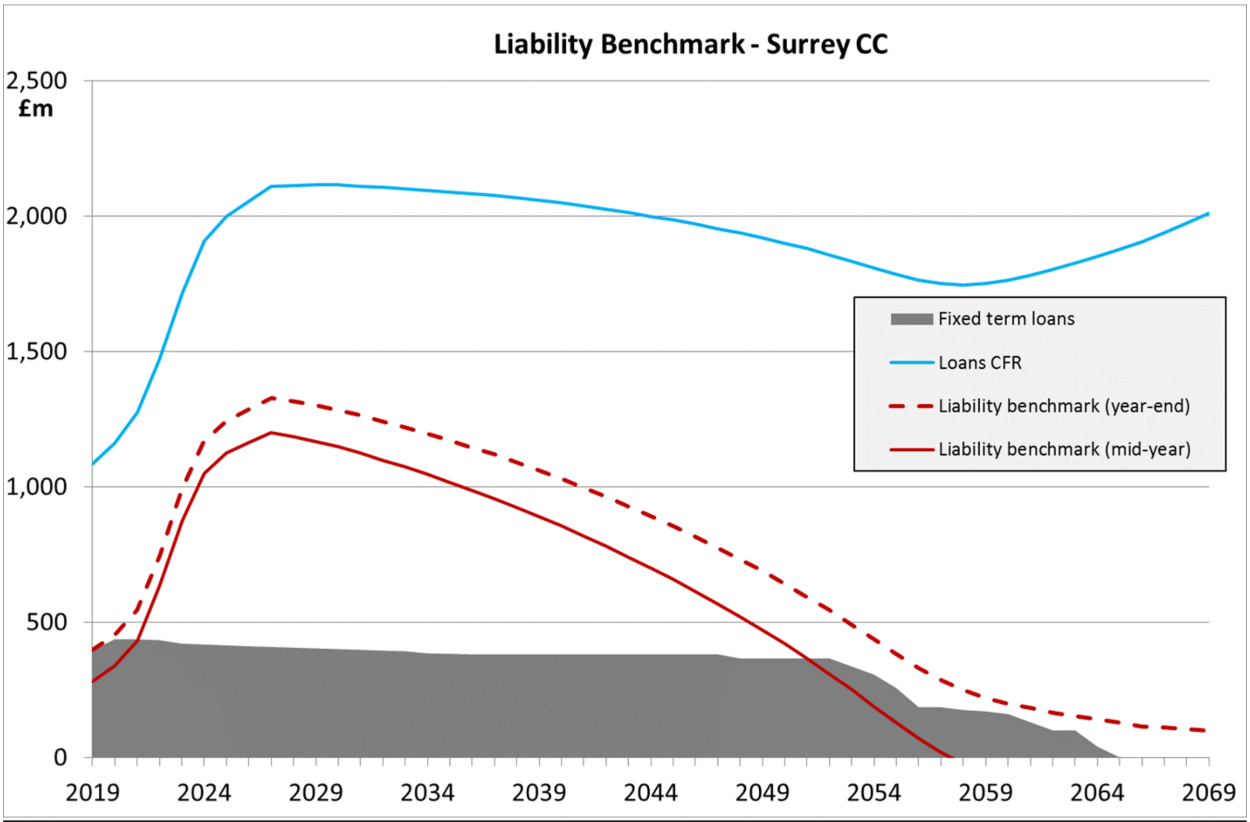
12. The Council has an increasing CFR over the period to 31 March 2025, due to the proposed Capital Programme and approved investment strategy projects. The maximisation of internal borrowing

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.

13. CIPFA's Prudential Code for Capital Finance in Local Authorities recommends that the Council's total debt should be lower than its highest forecast CFR over the next three years. Table 1 shows that the Council expects to comply with this recommendation during 2020/21.

14. 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



15. The long-term liability benchmark assumes:

- Capital expenditure funded by borrowing as per the 2020-25 Capital Programme
- Projects included in the Capital Programme (Budget and Pipeline) and approved investment strategy spend are 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 Medium-term Financial Plan (MTFS) and increase by inflation of 2.5% a year thereafter.

16. 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

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strategy to internally borrow continues to support the Council's financial position in the short to medium-term.

17. As shown, the Council's current debt portfolio is long dated and there are no significant repayments until the 2050s.

Borrowing Strategy

18. The Council is projected to have £726m of borrowing as at the end of March 2020, an increase of £50m since 31 March 2019. Long term borrowing has increased from £397m at 31 March 2019 to £437m - £40m of long-term loans were taken out as part of a balanced approach to managing interest rate risk. Short-term borrowing is expected to increase by £10m by the end of the year.

19. **Objectives:** The Council'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.

20. **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 Council'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 Council continues to maximise the use of internal resources (internal borrowing) and borrowing short-term to fund the additional requirement based on cash flow forecasts.

21. By doing so, the Council is able to supress net borrowing costs (despite foregone investment income) and reduce market and credit risk in the investment portfolio. However, short-term borrowing does increase the Council's exposure to changes in interest rates as when short-term loans mature they may need to be replaced at 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 2020/21, with a view to keeping future interest costs low.

22. Alternatively, the Council 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.

23. **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.

24. The Council 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 Council exposed to the risk of interest rate rises and are therefore subject to the interest rate exposure limits in the treasury management indicators below.

25. **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.

26. **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 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 through the Agency will therefore be the subject of a separate report.

27. **Debt rescheduling:** The PWLB allows Local 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 Council 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 efficiency or a reduction in risk.

Investment Strategy

28. The Council holds invested funds representing income received in advance of expenditure plus reserves. For the first half of 2019/20, the Council held average balances of £42m, compared to with £39m for the equivalent period in 2018/19. The average return for the first half of 2019/20 was 0.72%. Cash balances are expected to remain low during 2020/21.

29. **Objectives:** The CIPFA Code requires the Council 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 Council'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 Council 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.

30. **Negative interest rates:** If the UK enters into a recession in 2020/21, 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.

31. **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 2020/21. The majority of the Council'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.

32. 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.

33. **Business models**: Under the new International Financial Reporting Standard (IFRS 9) standard, the accounting for certain investments depends on the Council'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.

34. **Approved counterparties**: The Council 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.

35. **Table 2 - Approved investment counterparties and limits**

Credit rating	Banks unsecured	Banks secured	Government*
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	**n/a**
Pooled Funds	£25m per fund		

* UK Local Authorities

This table must be read in conjunction with the notes below.

36. **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.

37. **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.

38. **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.

39. **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.

40. **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.

41. Bond, equity and property funds offer enhanced returns over the longer term, but are more volatile in the short-term. These allow the Council 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 Council's investment objectives will be monitored regularly.

42. **Operational bank accounts:** The Council may incur operational exposures, for example though 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 Council maintaining operational continuity. The Council's bank, HSBC, has a credit rating of AA-.

43. **Risk assessment and credit ratings**: Credit ratings are obtained and monitored by the Council'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.

44. 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.

45. **Other information on the security of investments**: The Council 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.

46. 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 Council 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 Council'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.

47. **Investment limits**: The Council's revenue reserves and balances available to cover investment losses are forecast to be approximately £65m on 31st March 2020. 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

	Cash limit
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	£150m in total
Unsecured investments with Building Societies	10m in total

48. **Liquidity management:** The Council 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 Council being forced to borrow on unfavourable terms to meet its financial

commitments. Limits on long-term investments are set by reference to the Council's medium-term financial plan and cash flow forecast.

Treasury Management Indicators

49. The Council measures and manages its exposures to treasury management risks using the following indicators.

50. **Maturity structure of borrowing:** This indicator is set to control the Council'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%

51. 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.

52. **Principal sums invested for periods longer than 1 year:** The purpose of this indicator is to control the Council'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	2020/21	2021/22	2022/23
Limit on principal invested beyond year end	£40m	£20m	£10m

Other Items

53. There are a number of additional items that the Council is obliged by CIPFA and MHCLG to include in its treasury management strategy.

54. **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).

55. The Council 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 Council 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.

56. 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.

57. **Markets in Financial Instruments Directive**: The Council 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 Council's treasury management activities, the Section 151 Officer believes this to be the most appropriate status.

58. **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.

59. **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 Council 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

60. The budget for investment income in 2020/21 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 2020/21 is £19m, which is based on a mix of short-term borrowing and the existing long term fixed rate debt portfolio.

61. 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.

Alternative	Impact on income and expenditure	Impact on risk management
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

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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

Annex 1

Prudential and Treasury Indicators 2020/21

1. The Local Government Act 2003 requires the Council 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 Council 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 Council'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.

Table 1 - Actual and estimated capital expenditure

	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25
	Actual	Projected	← ----------------------	Estimated	----------------------	→	
	£m	£m	£m	£m	£m	£m	£m
Capital Programme expenditure	128	161	264	355	328	286	215
Approved investment strategy spend	100	7	13	23	11	9	0
Financed By:							
- Government grants and third party contributions	97	95	101	86	74	76	67
- Capital Receipts	11	5	22	75	0	0	0
- Revenue and reserves	1	1	8	6	6	7	6
Net financing need for the year*	**119**	**67**	**146**	**211**	**259**	**212**	**142**

*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 therefore measures a Council'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.

7. The CFR is increasing over the MTFS period which results in an increase in external debt (after we have maximised internal borrowing) and therefore an increase in the revenue cost of borrowing. This is reflected in an increased Operational Boundary and Authorised Limit as shown in Tables 4 and 5. Table 6 - Ratio of financing costs to net revenue stream, shows that the revenue cost of debt is an increasing but relatively low proportion of our overall budget. The impact of funding the Capital Programme is built into the revenue budget and MTFS.

Table 2 - Capital Financing Requirement (CFR)

	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25
	Actual	Projected	← --------------------		Estimated	-------------------- →	
	£m	£m	£m	£m	£m	£m	£m
Opening CFR	1,152	1,235	1,269	1,422	1,598	1,816	1,985
Movements:							
- Minimum revenue provision	(20)	(15)	(15)	(17)	(20)	(25)	(31)
- Application of capital receipts	(29)	0	0	0	0	0	0
- PFI & finance leases	13	(18)	22	(17)	(21)	(18)	(22)
- Net financing need	119	67	146	210	259	212	142
	83	34	153	176	218	169	89
Closing CFR	**1,235**	**1,269**	**1,422**	**1,598**	**1,816**	**1,985**	**2,074**

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

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.

Table 3 - Gross Borrowing Requirement							
	2018/19	**2019/20**	**2020/21**	**2021/22**	**2022/23**	**2023/24**	**2024/25**
	Actual	**Projected**	**← ---------------------**		**Estimated**		**--------------------- →**
	£m	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**
External Borrowing	675	726	837	1,038	1,278	1,458	1,562
CFR	1,235	1,269	1,422	1,598	1,816	1,985	2,074

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

<u>The Council's operational boundary for external debt</u>

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 Council's estimate of the most likely (ie prudent but not worst case) scenario for external debt. It links directly to the Council's estimates of capital expenditure, the CFR and cash flow requirements and is a key management to 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 Council'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. The operational boundary increases over the MTFS period to reflect an increasing underlying need to borrow linked to the Capital Programme. We monitor against the indicator throughout the year.

Table 4 - Operational Boundary						
	2019/20	**2020/21**	**2021/22**	**2022/23**	**2023/24**	**2024/25**
	Agreed	**← ---------------------**		**Estimated**		**--------------------- →**
	£m	**£m**	**£m**	**£m**	**£m**	**£m**
Borrowing	966	1,087	1,438	1,698	1,888	1,992
Other long term liabilities	143	136	119	98	80	58
Total	**1,109**	**1,223**	**1,557**	**1,796**	**1,968**	**2,050**
Estimated External Borrowing	716	837	1,038	1,278	1,458	1,562

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 Council 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. The authorised limit increases over the MTFS period to reflect an increasing underlying need to borrow linked to the Capital Programme.

Table 5 - Authorised Limit						
	2019/20	**2020/21**	**2021/22**	**2022/23**	**2023/24**	**2024/25**
	Agreed	**← --------------------- Estimated --------------------- →**				
	£m	**£m**	**£m**	**£m**	**£m**	**£m**
Borrowing	1,553	1,587	1,938	2,198	2,388	2,492
Other long term liabilities	143	136	119	98	80	58
Total	**1,696**	**1,723**	**2,057**	**2,296**	**2,468**	**2,550**
Estimated External Borrowing	716	837	1,038	1,278	1,458	1,562

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.

Table 6 - Ratio of Financing Costs to Net Revenue Stream						
	2019/20	**2020/21**	**2021/22**	**2022/23**	**2023/24**	**2024/25**
	Projected	**← ---------------------**		**Estimated**		**--------------------- →**
Ratio of Financing Costs to Net Revenue Stream	2.57%	3.18%	3.86%	4.61%	5.31%	6.45%

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)

Price risk indicator	**2020/21**	**2021/22**	**2022/23**
Limit on principal invested beyond year end	£40m	£20m	£10m

Refinancing risk - Maturity structure of borrowing

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%

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Annex 2

Arlingclose Economic & Interest Rate Forecast

Underlying assumptions:

- The global economy is entering a period of slower growth in response to political issues, primarily the trade policy stance of the US. The UK economy has displayed a marked slowdown in growth due to both Brexit uncertainty and the downturn in global activity. In response, global and UK interest rate expectations have eased.

- Brexit has been delayed until 31 January 2020. The General Election has removed some uncertainty within the market, however following the Withdrawal Bill, a key concern is the limited transitionary period following a January 2020 exit date, which will maintain and create additional uncertainty over the next few years.

- UK GDP growth rose by 0.4% in the third quarter of 2019 from -0.2% in the previous three months, with the annual rate falling further below its trend rate to 1.1% from 1.2%. Services, construction and production added positively to growth, by 0.5%, 1.2% and 0.1% respectively, while agriculture recorded a fall of 0.1%. Looking ahead, the Bank of England's Monetary Policy Report (formerly the Quarterly Inflation Report) forecasts economic growth to pick up during 2020 as Brexit-related uncertainties dissipate and provide a boost to business investment. This results in forecast GDP growth of 1.6% in Q4 2020, 1.8% in Q4 2021 and 2.1% in Q4 2022.

- Domestic inflationary pressures have abated, as domestic gas and electricity price freezes have taken effect until 2020. The price of oil has fallen through the year, despite a rise in prices in December 2019. The limited inflationary pressure from real wages will likely keep inflation below the Bank of England target of 2%. The Bank of England maintained Bank Rate to 0.75% in November following a 7-2 vote by the Monetary Policy Committee. Despite keeping rates on hold, MPC members did confirm that if Brexit uncertainty continues or global growth fails to recover, they are prepared to cut interest rates as required. Moreover, the downward revisions to some of the growth projections in the Monetary Policy Report suggest the Committee may now be less convinced of the need to increase rates.

- Inflation is running below target. While the tight labour market risks medium-term domestically-driven inflationary pressure, slower global growth should reduce the prospect of externally driven pressure, although political turmoil could push up oil prices.

- The US economy has continued to perform relatively well compared to other developed nations; however, the Federal Reserve has started to unwind its monetary tightening through 2019. The Federal Reserve has cut rates three times to 1.5% - 1.75%, to stimulate growth as GDP growth has started to fall (to 2.1%).

- The repercussions from the US-China trade war continues which, risks contributing to a slowdown in global economic activity in 2019. Recent suggestions have been an initial compromise and potential unwinding of tariffs; however, this can change quickly. Slow growth in Europe, combined with changes in leadership at the ECB and IMF has led to a change of stance in 2019. Quantitative easing has continued and been extended.

- Central bank actions and geopolitical risks will continue to produce significant volatility in financial markets, including bond markets.

Forecast:

- Although we have maintained our Bank Rate forecast at 0.75% for the foreseeable future, there are substantial risks to this forecast, dependant on the progression towards a post-Brexit trade arrangement and the evolution of the global economy.

- Arlingclose judges that the risks are weighted to the downside.

- Gilt yields have risen but remain low due to the soft UK and global economic outlooks. US monetary policy and UK government spending will be key influences alongside UK monetary policy.

- We expect gilt yields to remain at relatively low levels for the foreseeable future and judge the risks to be broadly balanced.

	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Average
Official Bank Rate														
Upside risk	0.00	0.00	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	**0.21**
Arlingclose Central Case	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	0.75
Downside risk	-0.50	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	**-0.73**
3-month money market rate														
Upside risk	0.10	0.10	0.25	0.25	0.25	0.25	0.25	0.25	0.30	0.30	0.30	0.30	0.30	**0.25**
Arlingclose Central Case	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	0.75
Downside risk	-0.50	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	**-0.73**
1yr money market rate														
Upside risk	0.10	0.20	0.20	0.20	0.20	0.20	0.20	0.25	0.30	0.30	0.30	0.30	0.30	**0.23**
Arlingclose Central Case	**0.85**	**0.85**	**0.85**	**0.85**	**0.85**	**0.85**	**0.85**	**0.85**	**0.85**	**0.85**	**0.85**	**0.85**	**0.85**	0.85
Downside risk	-0.30	-0.50	-0.55	-0.65	-0.65	-0.65	-0.65	-0.65	-0.65	-0.65	-0.65	-0.65	-0.65	**-0.60**
5yr gilt yield														
Upside risk	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	0.45	0.45	0.45	**0.37**
Arlingclose Central Case	**0.50**	**0.50**	**0.50**	**0.55**	**0.60**	**0.60**	**0.60**	**0.60**	**0.60**	**0.60**	**0.60**	**0.60**	**0.60**	0.57
Downside risk	-0.35	-0.50	-0.50	-0.55	-0.60	-0.60	-0.60	-0.60	-0.60	-0.60	-0.60	-0.60	-0.60	**-0.56**
10yr gilt yield														
Upside risk	0.30	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	0.40	0.45	0.45	**0.37**
Arlingclose Central Case	**0.75**	**0.75**	**0.80**	**0.80**	**0.85**	**0.85**	**0.90**	**0.90**	**0.95**	**0.95**	**1.00**	**1.00**	**1.00**	0.88
Downside risk	-0.40	-0.40	-0.40	-0.40	-0.45	-0.45	-0.45	-0.45	-0.50	-0.50	-0.50	-0.50	-0.50	**-0.45**
20yr gilt yield														
Upside risk	0.30	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	0.40	0.45	0.45	**0.37**
Arlingclose Central Case	**1.20**	**1.20**	**1.25**	**1.25**	**1.25**	**1.30**	**1.30**	**1.30**	**1.35**	**1.35**	**1.35**	**1.40**	**1.40**	1.30
Downside risk	-0.40	-0.40	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.50	-0.50	**-0.45**
50yr gilt yield														
Upside risk	0.30	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	0.40	0.45	0.45	**0.37**
Arlingclose Central Case	**1.20**	**1.20**	**1.25**	**1.25**	**1.25**	**1.30**	**1.30**	**1.30**	**1.35**	**1.35**	**1.35**	**1.40**	**1.40**	1.30
Downside risk	-0.40	-0.40	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.50	-0.50	**-0.45**

PWLB Certainty Rate (Maturity Loans) = Gilt yield + 1.80%
PWLB Local Infrastructure Rate (Maturity Loans) = Gilt yield + 0.60%

Annex 3

Investment & Debt Portfolio Position as at 31 March 2019

	Actual Portfolio £m	**Average Rate %**
External borrowing:		
Public Works Loan Board	387	4.10
Market	10	5.00
Local Authorities	279	0.8
Total external borrowing	**676**	
Other long-term liabilities:		
Private Finance Initiative	134	
Total other long-term liabilities	**134**	
Total gross external debt	**810**	
Treasury investments:		
Banks & building societies (unsecured)	-	
Government (incl. Local Authorities)	-	
Money Market Funds	31	0.51
Total treasury investments	31	
Net debt	**779**	

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

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