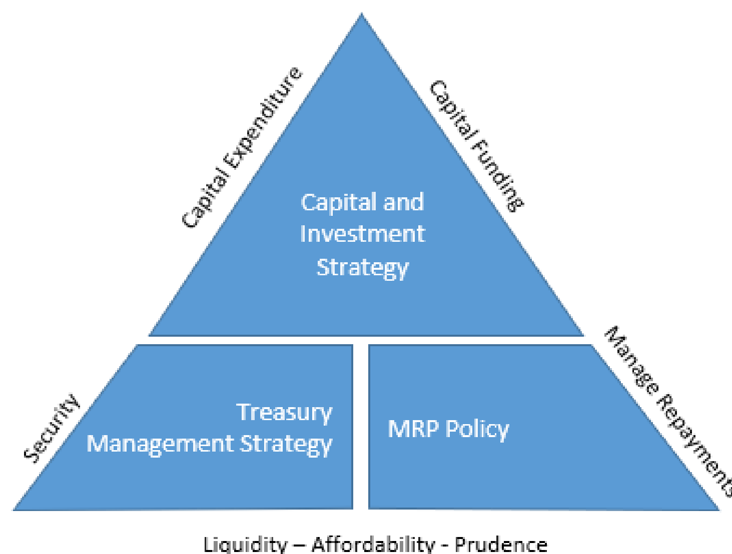
Surrey County Council

Capital, Investment and Treasury Management Strategy 2023/24

1. INTRODUCTION

1.1 The Capital, Investment and Treasury Management Strategy provides an overview of the three main components of capital planning. We have chosen to amalgamate the strategies into a single document because the Capital Programme, our Investment Strategy and our approach to Treasury Management cannot operate independently of one another. They are parts of an overall approach:

- **Capital expenditure and investments:** the Capital Programme; supporting Corporate and Directorate priorities and the Investment Programme; generating income and supporting economic growth;
- **Financing our capital plans, and maintaining liquidity:** the Treasury Management Strategy; setting out how the capital programme will be financed and how cash investments will be managed; and
- **Repaying our debt in a prudent way:** the Minimum Revenue Provision (MRP) Policy, setting out how we use the revenue budget to repay debt.



This report sets out a high-level overview of how capital expenditure, capital financing, investments and treasury management activity contributes to the provision of services along with an overview of how associated risk is managed and the implications for future financial sustainability.

1.2 The strategy sets out a clear picture of the ambition of the Council regarding capital expenditure and investment plans, within the financial constraints, risk appetite and regulatory framework that the Council operates.

1.3 The strategy is presented in the following elements, that set out the Council's approach to capital, investment and treasury management:

a. **Capital Overview** - asset management, capital expenditure planning, risk management and long-term sustainability of capital expenditure plans **(Section 2)**

b. **Investment Overview** – setting out investment plans focusing on the approach to service and commercially led investment **(Section 3);**
c. **The Treasury Management Strategy Statement (TMSS)** – setting out how we borrow and invest to support our capital financing requirement **(Section 4)**
d. **The Minimum Revenue Provision (MRP) Policy** – setting out how we repay capital borrowing **(included as the final page of this document, Annex G to the Budget)**

1.4 Decisions made this year on capital, investment and treasury management will have financial consequences for the Council for many years into the future. They are therefore subject to both a national regulatory framework and to local policy framework, summarised in this report.

1.5 Our strategy will:
- Set out how we ensure that capital expenditure contributes to the achievement of corporate priorities and the organisation strategy;
- Explain how the Capital Programme is financed and demonstrate that it is affordable and sustainable;
- Explain the Council's approach to investments; and
- Set out and fulfil the Council's regulatory requirements in respect of Borrowing, Treasury Management and Investment.

2. CAPITAL OVERVIEW

Capital Expenditure and Financing:

2.1 The Council incurs two types of capital expenditure:
- the service delivery Capital Programme
- the Capital Investment Programme

2.2 The Council's capital expenditure and financing plans over the medium-term provides an overview of the governance arrangements for approval and monitoring of expenditure and, in relation to commercial investment activities, sets out the due diligence process and the Council's risk appetite in respect of these, including proportionality in respect of overall resources.

2.3 This section includes a projection of the Council's capital financing requirement and how this will be funded and repaid. It links to the Council's borrowing strategy and sets out the Council's statutory duty to make an annual revenue provision for the repayment of debt, detailed in the MRP Policy (Annex G to the Budget).

Capital Expenditure

2.4 Capital expenditure refers to Local Authority spending on assets such as infrastructure, property or vehicles that will be used for more than one year. In Local Government this includes spending on assets owned by other bodies and loans and grants to other bodies, enabling them to buy assets.

2.5 In the 2023/24 Budget and 5-year Medium Term Financial Strategy to 2027/28, the Council has a total capital expenditure requirement of £1.98bn as summarised in Table 1. Our capital expenditure can be broken into three categories:

- Approved Capital Budget of £1,202m
- Capital Pipeline of £748m, schemes that represent the capital ambitions of the Council but are subject to further detailed business cases and Member approval.
- Capital Investments of £31m, split by investment in existing assets (£1m) and investment in new assets within Surrey (£30m).

Table 1 - Estimates of Capital Expenditure

	2021/22 Actual	2022/23 Forecast	2023/24 Budget	2024/25 Budget	2025/26 Budget	2026/27 Budget	2027/28 Budget	Total Budget
	£m	£m	£m	£m	£m	£m	£m	£m
Capital Programme - Budget	162	218	309	329	222	164	178	**1,202**
Capital Programme - Pipeline	0	30	108	221	217	158	44	**748**
Sub-total Capital Programme	162	249	416	551	439	323	221	**1,950**
Capital investment in existing assets	0	0	0	1	0	0	0	**1**
New growth and service led investments in Surrey	3	1	26	1	3	0	0	**30**
Sub-total Investment Strategy	3	1	26	2	3	0	0	**31**
TOTAL	**166**	**250**	**443**	**552**	**442**	**323**	**221**	**1,981**

2.6 Our medium-term approach to financial planning means we can deliver an ambitious Capital Programme of c£1.95bn over the next 5 years if all pipeline proposals are approved. The revenue implications of this proposed programme are integrated and factored into the financial planning over the Medium-Term Financial Strategy (MTFS) period.

2.7 In developing the capital expenditure estimates, we have ensured that borrowing costs remain in line with the revenue budget envelopes set out in the 2023/24 Budget and MTFS. This has been achieved through a combination of refining the borrowing requirement for pipeline schemes and through identifying a number of schemes that will generate income or efficiencies sufficient to cover their borrowing costs.

2.8 Planned capital investment will deliver significant investment in:

- The development of a greener future through the Net Zero 2030 and 2050 carbon reduction schemes and other projects contributing to the carbon and green agenda such as solar farms, electric charging points, low emission buses and vehicles;
- A reconfirmed commitment to Surrey's sustainable future and that of its residents and businesses, through significant investment in flood alleviation works; a once in a generation opportunity to build flood defences, country parks and green space;
- Community led projects in our towns and high streets with £60m available over the next 4 years through the Your Fund Surrey scheme;
- Developing Farnham town centre and surrounding infrastructure;

- Creating a number of sites to look after our vulnerable older adults, through building Extra Care and Independent Living accommodation where residents can live independently for longer and integrate into the community;
- Delivering additional local places for children with Special Educational Needs and Disabilities – a key part in containing costs within the revenue budget;
- Providing additional capacity in schools, to provide a rich education with Schools Basic Needs funding;
- Increasing sufficiency of provision for special education needs and disability in schools across Surrey;
- Investment in County PRU places and improvements for improved pupil support
- Investment in libraries across the County;
- Maintaining and developing our road infrastructure to help grow a sustainable economy, deliver safer and greener routes; and
- Accelerating our Property Rationalisation and Agile Corporate Estate Programme.

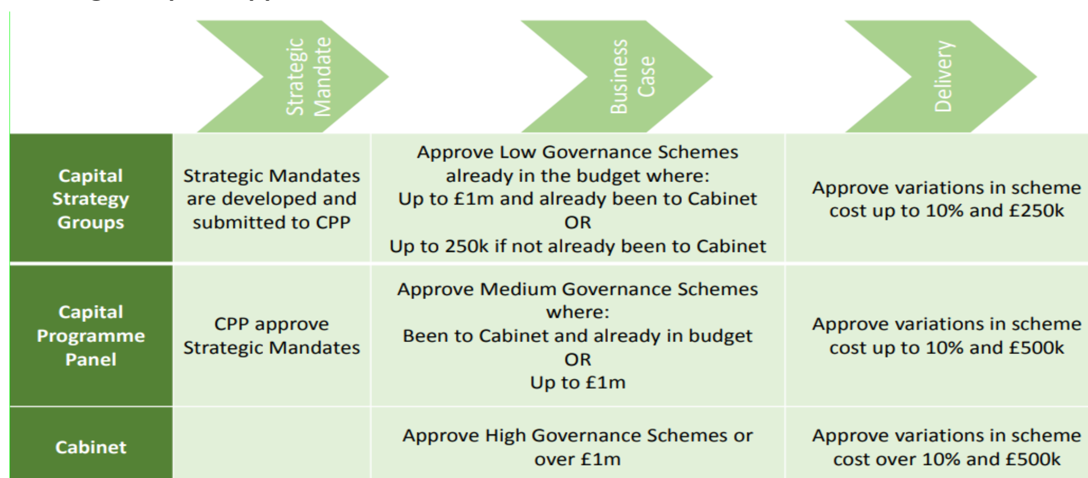
2.9 Capital projects are subject to a rigorous governance process to ensure they are aligned with the Council's priorities:

- Growing a sustainable economy so everyone can benefit;
- Tackling health inequality;
- Enabling a greener future; and
- Empowering communities.

2.10 Fundamentally, they are approved on the principles of strategic fit, value for money, affordability and deliverability. Projects need to demonstrate value for money and that they are capable of being delivered within expected timescales.

2.11 Strategic Capital Groups (SCGs) for Infrastructure, Property and IT develop projects throughout the budget setting process which are scrutinised and approved by Capital Programme Panel (CPP); a group of senior officers from across the organisation, including the Council's Deputy S151 officer and senior service representatives. Projects approved by CPP are then included in the budget when approved by Cabinet and Council. Fig 1, below summarises this process.

Fig 1: Capital Approval Process



	Strategic Mandate	Business Case	Delivery
Capital Strategy Groups	Strategic Mandates are developed and submitted to CPP	Approve Low Governance Schemes already in the budget where: Up to £1m and already been to Cabinet OR Up to 250k if not already been to Cabinet	Approve variations in scheme cost up to 10% and £250k
Capital Programme Panel	CPP approve Strategic Mandates	Approve Medium Governance Schemes where: Been to Cabinet and already in budget OR Up to £1m	Approve variations in scheme cost up to 10% and £500k
Cabinet		Approve High Governance Schemes or over £1m	Approve variations in scheme cost over 10% and £500k

Capital Funding

2.12 All capital expenditure must be financed, either from external sources (government grants and other contributions), the Council's own resources (revenue, reserves and capital receipts) or debt (borrowing, leasing and Private Finance Initiatives). The planned financing of the expenditure set out in Table 1 is as follows:

Table 2 - Capital Financing

	2021/22 Actual	2022/23 Forecast	2023/24 Budget	2024/25 Budget	2025/26 Budget	2026/27 Budget	2027/28 Budget	Total budget
	£m	£m	£m	£m	£m	£m	£m	£m
Grants and Contributions	79	108	145	153	174	110	75	657
Revenue budgets	6	6	7	6	6	6	6	31
Capital receipts	62	0	41	20	13	2	0	76
Borrowing	19	135	250	373	249	205	141	1,217
TOTAL	**166**	**250**	**443**	**552**	**442**	**323**	**221**	**1,981**

2.13 Additional borrowing of £250m for 2023/24 consists of £224m to fund the Capital Programme (detailed in the Capital Budget – See Annex C to the 2023/24 Budget and MTFS to 2027/28) and £26m to fund capital investment in existing assets and new growth and service led expenditure (set out in Table 1).

2.14 This table shows the planned usage of capital receipts for capital expenditure. £76m of capital receipts from the sale of Council assets are assumed for financing expenditure from 2023/24 onwards. Receipts are only included as sources of financing when there is a high level of confidence over the value and timing of their delivery. This approach is taken to ensure a prudent estimate of borrowing is factored into capital plans and included in the revenue budget for finance costs.

2.15 Borrowing is only a temporary source of finance, since loans and leases must be repaid, and this is therefore replaced over time by other financing, usually from revenue which is known as Minimum Revenue Provision (MRP).

2.16 Alternatively, proceeds from selling capital assets (known as capital receipts) may currently be used to replace debt finance. No use of receipts is currently assumed to repay existing debt.

2.17 Planned MRP is set out in the following table:

Table 3 - Repayment of Debt Finance through Minimum Revenue Provision

	2021/22 Actual	2022/23 Forecast	2023/24 Forecast	2024/25 Forecast	2025/26 Forecast	2026/27 Forecast	2027/28 Forecast
	£m	£m	£m	£m	£m	£m	£m
MRP	21	24	29	38	45	51	56

2.18 The Council's full MRP policy can be found in Annex G.

2.19 The Council's cumulative outstanding amount of debt finance is measured by the Capital Financing Requirement (CFR). This increases with new debt-financed capital expenditure on service delivery and on investments and reduces with MRP and capital receipts used to replace debt.

2.20 The CFR is expected to increase by £216m during 2023/24. Based on the above figures for expenditure and financing, the Council's estimated CFR over the medium-term is as follows:

Table 4 - Prudential Indicator: Estimates of Capital Financing Requirement

As at 31st March	2021/22 Actual	2022/23 Forecast	2023/24 Forecast	2024/25 Forecast	2025/26 Forecast	2026/27 Forecast	2027/28 Forecast
	£m	£m	£m	£m	£m	£m	£m
Capital Programme	888	1,004	1,202	1,540	1,745	1,904	1,992
Investment Programme	451	443	460	452	446	437	427
TOTAL CFR	**1,339**	**1,446**	**1,662**	**1,992**	**2,190**	**2,340**	**2,420**

2.21 Our capital plans lead to a £974m increase in the estimated CFR over the five-year period, from £1.45bn to £2.42bn. The revenue implications of this are set out below in section 2.26 and in the TMSS section 4.

2.22 **Asset management:** To ensure that capital assets continue to be of long-term use, the Council has an Asset and Place Strategy. This sets out the Council's approach to the strategic management of its assets, how the sale of assets to fund capital expenditure will support service delivery and provide the income to promote growth and place shaping within Surrey.

2.23 **Asset disposals:** When a capital asset is no longer needed, it may be sold so that the proceeds, known as capital receipts, can be spent on new assets or to repay debt. Repayments of capital grants, loans and investments also generate capital receipts. The Council currently has no plans to use flexible use of capital receipts from 2023/24 onwards.

2.24 The Council plans to receive £76m of capital receipts from 2022/23 onwards:

Table 5 - Capital Receipts Receivable

	2021/22 Actual	2022/23 Forecast	2023/24 Budget	2024/25 Budget	2025/26 Budget	2026/27 Budget	2027/28 Budget
	£m	£m	£m	£m	£m	£m	£m
Asset sales	2	26	17	11	7	15	-

Revenue Budget Implications

2.25 Although capital expenditure is not charged directly to the revenue budget, interest payable on loans, and MRP are charged to revenue, offset by any investment income receivable. This is referred to as net financing costs.

2.26 Current projections show that net financing costs will be contained within the central income and expenditure budget projections over the MTFS, rising from £24m net in 2022/23 to £69m net in 2027/28. The gross and net costs of financing our capital plans are set out in the table, below.

Table 6 – Net Finance Cost Budget

	2021/22 Actual	2022/23 Forecast	2023/24 Forecast	2024/25 Forecast	2025/26 Forecast	2026/27 Forecast	2027/28 Forecast
	£m	£m	£m	£m	£m	£m	£m
MRP (not including PFI)	21	24	29	38	45	51	56
Interest Cost	17	19	24	29	29	32	35
Gross Finance Cost	**38**	**42**	**54**	**67**	**75**	**83**	**91**
Investment Income	(21)	(19)	(22)	(22)	(22)	(22)	(22)
Net Finance Cost	**16**	**24**	**32**	**45**	**53**	**61**	**69**

2.27 The proportion of net finance cost to net revenue budget is a key indicator of direction of travel relative to medium term revenue resources and provides insight into the affordability of finance costs. Full revenue implications of net finance cost are set out in the TMSS (section 4.46 onwards)

2.28 The Council's net finance costs are increasing as a proportion of the net revenue budget, which is expected with an expanding Capital Programme, rising from c.2% in 2022/23 to 6% in 2027/28. This is increase is partially contained through schemes enabling delivery of revenue efficiencies or income generation that finance themselves and offset pressure on the central income and expenditure budget.

2.29 The below schemes are included in the Capital Programme on the basis of covering their own financing costs over the MTFS:

Approved Budget - £75m total spend over MTFS

- £29m – Children Looked After Schemes
- £24m – Independent Living (Batch 1)
- £7m - Surrey Outdoor Learning and Development - Thames Young Mariners
- £5m – Caterham Hill Library
- £5m – Unicorn Reprocurement/Replacement
- £2m - Extra Care Housing
- £2m – Greener Futures 2030 (PSDS3a)
- £1m – Various smaller schemes totalling £1m

Pipeline – £235m (to be approved after scrutiny of value for money, sustainability and assessment of deliverability)

- £60m - Extra Care Housing
- £44m – Greener Futures – Net Zero 2030 target
- £31m - Agile Office Estate Strategy (including Quadrant Court)
- £30m - Greener futures - Net Zero 2050 target

- £27m - Libraries Transformation Phase 1
- £21m - Materials Recovery Facility
- £9m - Independent Living
- £5m - Surrey Outdoor Learning & Development (SOLD)
- £3m – Children Looked After Schemes
- £2m - Electric Vehicle Infrastructure
- £2m – Surrey farms investment plan
- £1m – Various smaller schemes totalling £1m

Financial Sustainability

2.30 Due to the very long-term nature of capital expenditure and financing, the revenue budget implications of expenditure incurred over the MTFS will extend for up to 50 years into the future. The Section 151 Officer is satisfied that the proposed Capital Programme is prudent, affordable and sustainable because it remains proportional to the Council's overall revenue budget.

Environmental Sustainability

2.31 Capital expenditure over the next 5-year period includes c.£678m of schemes that will contribute to carbon reduction, action on climate change and enabling a greener future. Of this spend, c.£366m is included for schemes in the approved budget and a further c.£312m for schemes in the pipeline, which are subject to ongoing development, scrutiny and challenge before being approved. The Council will continue to take direct action on environmental sustainability for future generations as part of the Carbon Net Zero targets set for 2030 and 2050. The Council has brought in expertise to better understand and report on carbon impacts of the Capital Programme and to set established processes for assessing capital plans and capturing necessary information for business case scrutiny and benefits realisation.

3. INVESTMENT OVERVIEW

3.1 In addition to service-led capital expenditure, the Council has invested its money for a further three broad purposes:

- To support local public services by setting up, lending to or buying shares in other organisations (service investments);
- To earn investment income (known as commercial investments where this is the main purpose); and
- As a result of surplus cash from its day-to-day activities, for example when income is received in advance of expenditure (known as treasury management investments);

Service Investments: Loans and Equity

3.2 **Overview:** The Council invests money in its subsidiaries and other organisations to support local public services and stimulate local economic growth. Subsidiaries of this nature include:

- Hendeca Group Ltd (formerly S.E. Business Services Ltd) – a Local Authority Trading Company (LATC) wholly owned by the Council for the provision of business services.
- Surrey Choices Ltd – a LATC, wholly owned by the Council to deliver day services and community support options for people with disabilities and older people.

3.3 **Security:** The main risk when making service loans is that the borrower will be unable to repay the principal lent and/or the interest due. In order to limit this risk and ensure that total exposure to service loans remains prudent, decisions on service loans are made in the context of their value, the stability of the counterparty and an assessment of the risk of default. The current value of service loans is set out as follows:

Table 7 - Loans for service purposes in £ millions

Category of borrower	31.3.2022 actual			2023/24
	Balance owing £m	Loss allowance £m	Net figure in Accounts £m	Approved Limit £m
Subsidiaries	3	-	3	10

3.4 Accounting standards require the Council to set aside loss allowance for loans, reflecting the likelihood of non-payment. The figures for loans in the Council's Statement of Accounts are shown net of this loss allowance. However, the Council makes every reasonable effort to collect the full sum advanced and has appropriate credit control arrangements in place to recover overdue repayments. In the case of our service loans, these allowances are nil.

3.5 **Risk assessment:** The Council assesses the risk of loss before entering into and whilst holding service loans by reference to their financial position, past experience and other factors. We wholly own our subsidiaries for service purposes and so their financial position is subject to the same rigour and control as that of the Council.

Commercial Investments: Property

3.6 **Overview:** The Council holds investments in local commercial property; office space, leisure and retail, with the intention of supporting Surrey's economy and generating a surplus that will be spent on local public services. The table below shows the value of our investments by main category, including those under construction where the ultimate use is to be determined.

Table 8 - Property held for investment purposes in £ millions

Property	Actual	31.3.2022 actual	
	Purchase cost £m	Gains or (losses) £m	Closing Value £m
Office	117	9	127
Retail	6	(3)	3
Leisure	1	0	1
TOTAL	**124**	7	**131**

3.7 **Security:** In accordance with government guidance, the Council considers a property investment to be secure if its accounting valuation is at or higher than its purchase cost including taxes and transaction costs.

3.8 A fair value assessment of the Council's investment property portfolio has been made within the past twelve months, and the underlying assets provide security for capital investment. The Council holds investment properties for long-term rental income, and short-term fluctuation in investment values can be expected. Our investment properties operate in a challenging commercial environment, with particular pressure on retail. We continue to explore mitigating actions to protect the capital invested, such as alternate uses where appropriate.

Commercial Investment – Equity Investments and Loans

3.9 **Overview:** The Council wholly owns Halsey Garton Property Ltd (HGP) which has a portfolio of national investment properties used to generate a return to the Council. The Council also wholly owns Halsey Garton Residential Ltd (HGR), which holds a portfolio of Surrey-based residential properties. The financial return from both companies takes the form of interest on the outstanding loan and dividend payments (where possible). The total value of our investment in HGP and HGR as at 31st March 2022 is set out below.

Table 9 - Equity and Loans to HGP and HGR in £ millions

Category of Investment	31.3.2022 actual		
	Balance outstanding	Loss allowance	Net figure in Accounts
	£m	£m	£m
Equity Shares	97	0	97
Loans	241	(1)	240

3.10 Accounting standards require the Council to set aside loss allowance for investments, reflecting an assessment of risk. The figures in the Council's Statement of Accounts are shown net of this loss allowance. However, the Council makes every reasonable effort to collect the

full sum advanced and has appropriate credit control arrangements in place to recover overdue repayments.

3.11 The Council also holds shares at a £0.5m initial cost in the UK Municipal Bonds Agency (UKMBA) whose aim is to reduce the long-term borrowing costs of Local Authorities who join together to issue local authority bonds. The Council does not currently have a bond-issue with UKMBA but is taking regular advice from its Treasury advisors, Arlingclose on the most appropriate source of finance for its long-term capital spending plans. The share value has been written out of the Council's balance sheet because the UKMBA set out a material uncertainty in its November 2020 accounts that would cast doubt on the company's ability to continue as a going concern.

Managing the debt used to finance subsidiary loans

3.12 In previous financial years, the Council has borrowed money to lend on to Halsey Garton Property, in order that Halsey Garton Property can invest in property to generate a revenue income for the Council to support service delivery. Alongside the equity shares, these loans are set out in Table 9, above.

3.13 The Council's MRP policy for 2021/22 was to charge MRP on individual properties where the market value had fallen below the outstanding loan, ensuring that the debt coverage was maintained. This was deemed a prudent approach and therefore compliant with current legislation because, despite individual properties carrying a market value below the debt, the value of the portfolio overall still exceeded the outstanding loans.

3.14 In November 2021, the Government issued a consultation on proposed changes to capital finance regulations. The potential change in stance arising from this consultation would have dictated that local authorities charge MRP on all subsidiary loans, to ensure the money is set aside to repay debt without relying on the subsidiary selling assets or negotiating new debt.

3.15 In anticipation of these changes coming into force for the 2023/24 financial year, as per the government's proposed timetable, the Council took the decision to adopt the regulations early and amended its MRP policy for 2022/23 to provide MRP on capital loans in full as it does for any other asset. This policy was approved by Full Council on 8th February 2022.

3.16 In June 2022, the Government issued an interim response to the consultation, which included an amended proposal in respect of capital loans. The amended proposal is that, where an authority has made a capital loan for service purposes, MRP need only be made to cover the expected credit loss required by IFRS 9. Zero MRP is acceptable if the outstanding CFR on the loan is no greater than the outstanding principal, less any expected credit losses.

3.17 The Council's current policy of providing for MRP in full means it is compliant with both the original and revised proposals. A full response to the consultation has not yet been issued and therefore there is not yet complete certainty over the final nature and timing of any changes, if indeed they are introduced.

3.18 Given these circumstances the Council considers it prudent to continue with the current policy of providing MRP in full on loans to subsidiaries in 2023/24, as outlined in the 2023/24 MRP Policy (Annex G). This will ensure that the Council's debt in relation to the loan to Halsey Garton is serviced over the life of the asset. When the subsidiary repays its loans, any resulting surplus would be recognised as gain (a capital receipt) at the point of repayment.

Security

3.19 The value of property owned by Halsey Garton Property Ltd at 31st March 2022 was assessed as being £38m lower than cost, representing an 12% reduction, largely due to pressures on the retail environment.

3.20 Halsey Garton is holding the assets for long-term rental income and short-term variations in fair value do not currently affect the value of the Council's investment. Over the long term, we would expect asset values to recover.

Risk Assessment and Liquidity

3.21 **Risk assessment:** The Council assesses the risk of loss before entering into and whilst holding property or subsidiary investments through a thorough analysis of the market and economic conditions using external advisors where necessary. Separately, the Council has a comprehensive risk management strategy to mitigate risks of over-spend or income shortfalls to the base budget position.

3.22 **Liquidity:** Compared with other investment types, property is relatively difficult to sell and convert to cash at short notice and can take a considerable period to sell in certain market conditions. The Council is not reliant on investments in property to maintain its liquidity and manages liquidity through other investments and borrowing. The Council has Reserves and Contingencies to maintain stability in the event of a period of lower returns from its investment portfolio.

Loan Commitments and Financial Guarantees

3.23 Although not strictly counted as investments, since no money has exchanged hands yet, loan commitments and financial guarantees carry similar risks to the Council and are included here for completeness.

3.24 We do not currently extend financial guarantees to other organisations, however if we chose to be part of a joint bond issue with UKMBA, we would be liable for defaults of other Local Authorities in proportion to the total amount of the bond. It is highly unlikely that another Local Authority would default and so the risk is theoretical rather than a practical reality.

Proportionality

3.25 The Council's revenue budget includes an element of profit generating investment activity to support services. Table 10 below shows the extent to which the expenditure planned to meet the service delivery objectives and/or place making role of the Council is dependent on

achieving the expected net profit from investments over the lifecycle of the MTFS. Investment activity is forecast to remain around 2% of the Council's net revenue budget over the medium-term. Should we fail to achieve the expected net return, the Council would manage the impact on budget through use of contingency in the current financial year and a re-assessment of financial plans for the remainder of the medium-term.

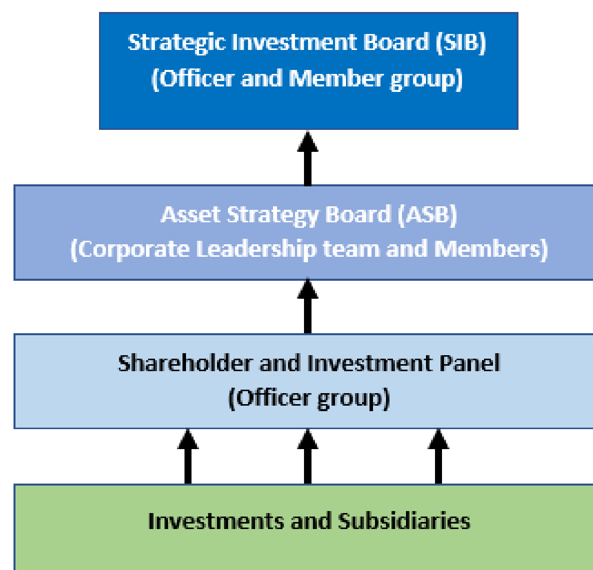
Table 10 - Proportionality of Investments

Investments net return	**2021/22 Actual £m**	**2022/23 Forecast £m**	**2023/24 Forecast £m**	**2024/25 Forecast £m**	**2025/26 Forecast £m**	**2026/27 Forecast £m**	**2027/28 Forecast £m**
Service investments	0.0	**0.0**	0.0	0.0	0.0	0.0	0.0
Commercial investments: Property	6.2	**3.6**	5.2	6.2	6.4	6.4	6.4
Commercial investments: Shares and Loans	15.1	**14.9**	14.9	14.9	14.9	14.9	14.9
Total Net Income from Investments	**21.3**	**18.5**	**20.1**	**21.1**	**21.3**	**21.3**	**21.3**
Proportion to Net Revenue Budget (%)	**2.1%**	**1.8%**	**1.8%**	**1.9%**	**2.0%**	**2.0%**	**2.0%**

Commercial Governance

3.26 Commercial investments are taken through a rigorous Officer and Member led process to ensure that decisions are taken with an adequate level of scrutiny. The diagram, below, shows the governance groups charged with delivering commercial investments:

Fig 2: Commercial Governance



3.27 At officer level, oversight is provided by the Shareholder Investment Panel (SHIP) with representation from Finance (Chair), Land & Property and Legal.

3.28 The Member led Strategic Investment Board (SIB) monitors the Council's investment properties and subsidiary companies to ensure satisfactory performance and effective risk management. The financial returns delivered by trading and investment help to ensure that we continue to deliver quality services to our residents.

3.29 SIB provides effective oversight, ensuring alignment with the strategic objectives and values of the Council. SIB safeguards the Council's interests and takes decisions in matters that require the approval of the Council as owner or as a shareholder of a company.

Investment Indicators

3.30 The Council has set the following quantitative indicators to allow elected members and the public to assess the Council's total risk exposure as a result of its investment decisions.

3.31 **Total risk exposure:** The first indicator shows the Council's total exposure to potential investment losses. This includes amounts the Council is contractually committed to lend but have yet to be drawn down and guarantees the Council has issued over third-party loans.

Table 11 - Total investment exposure in £millions

Total investment exposure	31.03.2022 Actual	31.03.2023 Forecast	31.03.2024 Forecast
	£m	£m	£m
Treasury management investments	141	20	50
Service investments: Loans	3	3	3
Commercial and Economic Growth investments: Property	131	132	158
Commercial investments: Loans	241	241	241
Commercial investments: Shares	97	97	97
TOTAL INVESTMENTS	**613**	**493**	**549**

3.32 **How investments are funded:** Government guidance states that our indicators should include an analysis of how investments are funded. Councils, including SCC, do not generally associate borrowing with individual assets, since we borrow as required to fund the whole portfolio of capital spend. However, the following investments could be described as being funded from capital sources, including borrowing and receipts. The remainder of the Council's investments are funded by Usable Reserves and income received in advance of expenditure.

Table 12 - Investments funded by borrowing in £millions

Total investment exposure	31.03.2022 Actual	31.03.2023 Forecast	31.03.2024 Forecast
	£m	£m	£m
Commercial and Economic Growth investments: Property	131	132	158
Commercial investments: Loans	241	241	241
Commercial investments: Shares	97	97	97
TOTAL INVESTMENTS	**469**	**470**	**496**

3.33 **Rate of return received:** This indicator shows the investment income received less the associated costs, including the cost of borrowing where appropriate, as a proportion of the sum initially invested. Note that due to the complexity of the Local Government accounting framework, not all recorded gains and losses affect the revenue account in the year they are incurred.

Table 13 - Investment rate of return (net of all costs)

Investments net rate of return	2021/22 Actual	2022/23 Forecast	2023/24 Forecast	2022/23 Forecast
	£m	£m	£m	%
Service investments	0.0	0.0	0.0	0%
Commercial investments: Property	6.2	3.6	5.2	3%
Commercial investments: Shares and Loans	15.1	14.9	14.9	4%
ALL INVESTMENTS	**21.3**	**18.5**	**20.1**	**4%**

External context

3.34 In 2018, following concerns from the sector regarding the adoption of International Financial Reporting Standard 9 (IFRS 9) into the Code of Practice on Local Authority Accounting (the Code), the government introduced a statutory override to mitigate the risks highlighted by the sector. At that time, authorities had expressed concern that reporting changes brought in by IFRS 9 would mean that the fair value movements in certain assets would need to be reflected in budgets. This would have particularly affected investments in pooled investment funds, a type of investment widely held in the sector. Authorities argued that the increased volatility to budgets could impact service delivery or place undue burdens on council taxpayers.

3.35 The statutory override mitigates these putative risks by requiring authorities to remove the impacts of the fair value movements of pooled investment funds from their budgets and record them in an unusable reserve. The statutory override was time-limited to five years, from 1 April 2018 and ending 31 March 2023. At that time, the government said that it would keep use of the statutory override under review but made no further commitments.

3.36 In August 2022, the Government launched a consultation on whether to extend the override, make it permanent or allow it to lapse. The aim of this consultation was to collect the views of authorities and other stakeholders, and to collect additional information needed to understand the financial risks associated with both continuing the statutory override or allowing reversion to the Code of practice on local authority accounting. The responses to the consultation have now been considered, and Ministers have decided to extend the existing IFRS 9 statutory accounting override for a further 2 years until 31 March 2025. A full government response is expected in early 2023.

4. Treasury Management Strategy Statement 2023/24

Introduction

4.1 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 2021 Edition* (the CIPFA Code) which requires the Council to approve a treasury management strategy before the start of each financial year.

4.2 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 is set out in Annex 1 and a number of Treasury limits and indicators are set out below.

4.3 Treasury management is the management of the Council's cash flows, borrowing, 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.

4.4 The Council tends to be cash rich in the short-term as revenue income (e.g. Council Tax, Business Rates and Government Grants) is typically received before it is spent, but cash poor in the long-term as capital expenditure is incurred before being financed. Surplus cash is invested until required, while a shortage of cash will be met by borrowing, to avoid excessive credit balances or overdrafts in the bank current account.

4.5 Managing the cost of the Council's borrowing is at the heart of the Treasury Management Strategy (TMS) and we work proactively with our Treasury Management advisor, Arlingclose on a continual basis, to ensure that our approach represents the best balance between minimising cost and managing the risk of interest rate changes. Regular meetings with Arlingclose coincide with Bank of England Monetary Policy Committee meetings, however our strategy is under constant review throughout the year, and we can call on Arlingclose's expertise whenever required.

4.6 **Interest rate risk mitigation:** The increases to interest rates made by the Bank of England, and anticipation of further rises in the immediate future also have an impact on the affordability of the capital programme. The Council is looking to maximise its internal and short-term borrowing strategy to reduce the need to enter into long term borrowing at higher rates of interest over the short term. The Bank of England and other market intelligence suggests that interest rates will be high over the next 18-24 months and then will need to reduce, as inflation and growth reduces, due to a projected period of recession. Therefore a balance needs to be made between increasing the base budget for high interest rates, resulting in a larger required efficiency target, and managing a short term peak in interest rates through other strategies as follows:

- Our borrowing strategy requires us to maximise internal borrowing by utilising internal balances held for the medium term
- Our borrowing strategy also enables us to borrow short term at cheaper rates to avoid 'locking' in long term interest charges when interest rates are high
- Historic trends suggest that pipeline conversion and capital programme spending will be less than the current profiling in the draft budget.
- The Council holds an interest rate risk reserve of £1.6m if interest payable in the year exceeds the revenue budget available, after the mitigations set out above.

Interest rate volatility has effectively been managed throughout 2022/23 to-date through this strategy and higher than forecast cash levels. Cash levels have benefited from significant grant income received upfront in the financial year and, more significantly, £50m of long term borrowing taken out in March 2022 (at 1.98%) before rates began to rise.

4.7 The Treasury Management Strategy is supported by four TMS annexes:

1. Prudential indicators – a Code requirement which supports our approach to borrowing, managing risk and highlighting our capital financing requirement.
2. Detailed external context – a detailed summary from Arlingclose of the current and future economic climate, risks and opportunities along with detailed interest rate forecasts.
3. Investment & Debt Portfolio Position as at 30 November 2022 – to highlight the current range of debt and investments.
4. Glossary of Terms

External Context – as at November 2022 (Bank Rate update is as at December)

4.8 **Economic background:** The ongoing impact on the UK from the war in Ukraine, together with higher inflation, higher interest rates, uncertain government policy, and a deteriorating economic outlook, will be major influences on the Council's treasury management strategy for 2023/24.

4.9 The Bank of England (BoE) increased Bank Rate by 0.5% to 3.5% in December 2022. This followed a 0.75% rise in November which was the largest single rate hike since 1989 and the ninth successive rise since December 2021. The December decision was voted for by a 6 3 majority of the Monetary Policy Committee (MPC), with two dissenters voting for a no-change at 3% and one for a larger rise of 0.75%.

4.10 The November quarterly Monetary Policy Report (MPR) forecast a prolonged but shallow recession in the UK with CPI inflation remaining elevated at over 10% in the near-term. While the projected peak of inflation is lower than in the August report, due in part to the government's support package for household energy costs, inflation is expected remain higher for longer over the forecast horizon and the economic outlook remains weak, with unemployment projected to start rising.

4.11 The UK economy contracted by 0.3% between July and September 2022 according to the Office for National Statistics, and the BoE forecasts Gross Domestic Product (GDP) will decline 0.75% in the second half of the calendar year due to the squeeze on household income from higher energy costs and goods prices. Growth is then expected to continue to fall throughout 2023 and the first half of 2024.

4.12 CPI inflation is expected to have peaked at around 11% in the last calendar quarter of 2022 and then fall sharply to 1.4%, below the 2% target, in two years' time and to 0% in three years' time if Bank Rate follows the path implied by financial markets at the time of the November MPR (a peak of 5.25%). However, the BoE stated it considered this path to be too high, suggesting that the peak in interest rates will be lower, reducing the risk of inflation falling too far below target. Market rates have fallen since the time of the November MPR.

4.13 The labour market remains tight for now, with the most recent statistics showing the unemployment rate was 3.7%. Earnings were up strongly in nominal terms by 6.1% for both total pay and for regular pay but factoring in inflation means real pay for both measures was -2.7%. Looking forward, the November MPR shows the labour market weakening in response to the deteriorating outlook for growth, leading to the unemployment rate rising to around 6.5% in 2025.

4.14 Interest rates have also been rising sharply in the US, with the Federal Reserve increasing the range on its key interest rate by 0.5% in December 2022 to 4.25%-4.5%. This rise follows four successive 0.75% rises in a pace of tightening that has seen rates increase from 0.25%-0.50% in March 2022. Annual inflation has been slowing in the US but remains above 7%. GDP grew at an annualised rate of 3.2% (revised up from 2.9%) between July and September 2022, but with official interest rates expected to rise even further in the coming months, a recession in the region is widely expected at some point during 2023.

4.15 Inflation rose consistently in the Euro Zone since the start of the year, hitting a peak annual rate of 10.6% in October 2022, before declining to 10.1% in November. Economic growth has been weakening with an upwardly revised expansion of 0.3% (from 0.2%) in the three months to September 2022. As with the UK and US, the European Central Bank has been on an interest rate tightening cycle, pushing up its three key interest rates by 0.50% in December, following two consecutive 0.75% rises, taking its main refinancing rate to 2.5% and deposit facility rate to 2.0%.

4.16 **Credit outlook:** Credit default swap (CDS) prices have generally followed an upward trend throughout 2022, indicating higher credit risk. They have been boosted by the war in Ukraine, increasing economic and political uncertainty and a weaker global and UK outlook, but remain well below the levels seen at the beginning of the Covid-19 pandemic.

4.17 CDS price volatility was higher in 2022 compared to 2021 and the divergence in prices between ringfenced (retail) and non-ringfenced (investment) banking entities has emerged once again.

4.18 The weakening economic picture during 2022 led the credit rating agencies to reflect this in their assessment of the outlook for the UK sovereign as well as several local authorities and financial institutions, revising them from to negative from stable.

4.19 There are competing tensions in the banking sector which could impact bank balance sheet strength going forward. The weakening economic outlook and likely recessions in many regions increase the possibility of a deterioration in the quality of banks' assets, while higher interest rates provide a boost to net income and profitability.

4.20 However, the institutions on our adviser Arlingclose's counterparty list remain well-capitalised and their counterparty advice on both recommended institutions and maximum duration remain under constant review and will continue to reflect economic conditions and the credit outlook.

4.21 **Interest rate forecast (December 2022):** The Council's treasury management adviser Arlingclose forecasts that Bank Rate will continue to rise in 2022 and 2023 as the Bank of England attempts to subdue inflation which is significantly above its 2% target.

4.22 While interest rate expectations reduced during October and November 2022, multiple interest rate rises are still expected over the forecast horizon despite looming recession. Arlingclose expects Bank Rate to rise to 4.25% by June 2023 under its central case, with the risks in the near- and medium-term to the upside should inflation not evolve as the Bank forecasts and remains persistently higher.

4.23 Yields are expected to remain broadly at current levels over the medium-term, with 5-, 10- and 20-year gilt yields expected to average around 3.5%, 3.5%, and 3.85% respectively over the 3-year period to December 2025. The risks for short, medium and longer-term yields are judged to be broadly balanced over the forecast horizon. As ever, there will undoubtedly be short-term volatility due to economic and political uncertainty and events.

4.24 A more detailed economic and interest rate forecast provided by Arlingclose is attached in the TMS Annex 2.

4.25 For the purpose of setting the budget, it has been assumed that new treasury management investments will be made at an average rate of 3%, and that new borrowing will be sourced at an average rate of 4% for 2022/23 and 2023/24, 3% in 2024/25 and 2% for the remainder of the MTFS period.

Local Context:

4.26 On 31 March 2022 the Council held £722m borrowing (£496m of long-term borrowing and £226m short-term borrowing) and £141m of cash investments. By 30th November 2022, this had dropped to £594m borrowing (£483m of long-term borrowing and £111m of short-term borrowing), with £100m of investments.

4.27 The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while balance sheet resources 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.

4.28 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 14 below.

Table 14 - Balance sheet summary and forecast

	31.3.22 Actual £m	31.3.23 Forecast £m	31.3.24 Forecast £m	31.3.25 Forecast £m	31.3.26 Forecast £m	31.3.27 Forecast £m	31.3.28 Forecast £m
General Fund CFR	1,339	1,446	1,662	1,992	2,190	2,340	2,420
Less: PFI and lease liabilities	(91)	(87)	(82)	(77)	(73)	(68)	(63)
Net CFR (underlying need to borrow)	**1,248**	**1,360**	**1,580**	**1,915**	**2,118**	**2,273**	**2,357**
Less: External borrowing (long term)	(496)	(484)	(474)	(466)	(458)	(449)	(444)
Internal borrowing (based on projection of level of reserves, balances and working capital)	(524)	(599)	(599)	(599)	(599)	(618)	(637)
Projected additional external borrowing requirement	**228**	**277**	**507**	**850**	**1,061**	**1,205**	**1,276**

4.29 The Council has an increasing CFR over the period to 31 March 2028, 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.

4.30 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 14 shows that the Council expects to comply with this recommendation across the medium-term.

4.31 Liability benchmark: To compare the Council's actual borrowing against an alternative strategy, a liability benchmark has been calculated showing the lowest risk level of borrowing. This assumes the same forecasts as table 14 above, but that cash and investment balances are kept to a minimum level of £50m at each year-end to maintain sufficient liquidity but minimise credit risk.

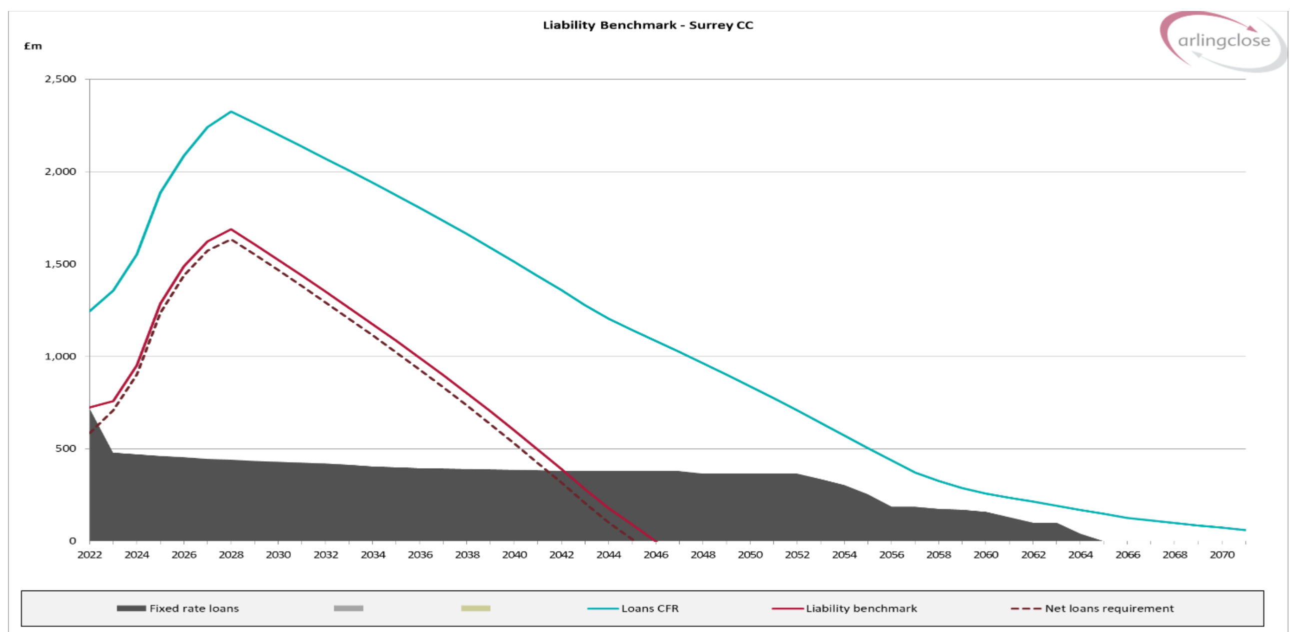
4.32 The liability benchmark is an important tool to help establish whether the Council is likely to be a long-term borrower or long-term investor in the future, and so shape its strategic focus

and decision making. The liability benchmark itself represents an estimate of the cumulative amount of external borrowing the Council must hold to fund its current capital and revenue plans while keeping treasury investments at the minimum level required to manage day-to-day cash flow.

Table 15 – Liability Benchmark

Position at 31 March	2021/22	2022/23	2023/24	2024/25	2025/26	2026/27	2027/28
	Actual	Projected	← -------------------		Estimated	------------------- →	
	£m	£m			£m		
Loans CFR	1,248	1,360	1,580	1,915	2,104	2,258	2,342
External borrowing	(725)	(484)	(474)	(466)	(458)	(449)	(444)
Internal (over) borrowing	523	876	1,106	1,449	1,647	1,808	1,898
Balance sheet resources	(662)	(649)	(649)	(649)	(649)	(669)	(690)
Net investments / (new borrowing)	138	(227)	(457)	(800)	(998)	(1,139)	(1,208)
Treasury investments	138	50	50	50	50	51	53
New borrowing	0	277	507	850	1,048	1,190	1,260
Net loans requirement	587	711	930	1,266	1,455	1,589	1,652
Liquidity allowance	50	50	50	50	50	51	53
Liability benchmark	**637**	**761**	**980**	**1,316**	**1,505**	**1,640**	**1,705**

<u>Graph 1: Liability benchmark</u>



4.33 The long-term liability benchmark assumes:

- Capital expenditure funded by borrowing as per the 2023-28 Capital Programme, with no further assumed expenditure factored in beyond the MTFS period;
- 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 attached 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 thereafter; and
- The benchmark is based on our assumptions on capital expenditure and the external loans requirement may not ultimately reduce to zero as future capital expenditure is approved.

4.34 Overall, the liability benchmark shows that we are currently borrowing exactly what we need, because the amount of external debt (grey shaded are) matches the liability benchmark (red line). As we progress over the medium term, the gap between total external debt and the liability benchmark grows, meaning that we need to borrow more money to meet our financing requirement. We aim to avoid a scenario where our external debt exceeds our liability benchmark, as it indicates that we are borrowing more than we need – i.e. borrowing to invest, carrying with it an increased risk of investment returns.

4.35 The difference between the CFR (underlying need to borrow – represented by the blue line) 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.

4.36 As shown, the Council's current debt portfolio is long dated and there are no significant repayments until the 2050s. An alternate strategy would be to increase our long-term fixed rate borrowing now. The liability benchmark illustrates that if we were to do so, it would be for a reasonably modest amount over a period of up to 20 years (to avoid a significant amount of fixed-rate debt exceeding our liability benchmark).

Borrowing Strategy

4.37 **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. To achieve this, the key aim is to maximise internal borrowing and use short-term borrowing to manage cashflow shortfalls, striking a balance between cheaper short-term loans and long-term fixed rate loans where the future cost is known but higher. The authority does not borrow to invest for the primary purpose of financial return and therefore retains full access to the Public Works Loans Board.

4.38 **Strategy**: The Council is facing unprecedented financial pressures, principally driven by rising need for services from residents and the increasing costs of providing such services. 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. 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.

4.39 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.

4.40 The level and mix of internal, short-term, and long-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 2023/24.

4.41 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. Although is unlikely to be beneficial when prevailing interest rates are higher than forecast future rates.

4.42 **Sources of borrowing:** The approved sources of long-term and short-term borrowing are:

- HM Treasury's Public Works Loan Board (PWLB);
- 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; and
- UK Municipal Bonds Agency plc and other special purpose companies created to enable Local Authority bond issues.

4.43 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.

4.44 Under the new Prudential Code, an authority must not borrow to invest primarily for financial return. It is not prudent for local authorities to make any investment or spending decision that will increase the capital financing requirement, and so may lead to new borrowing, unless directly and primarily related to the functions of the authority and where any financial returns are either related to the financial viability of the project in question or otherwise incidental to the primary purpose. Authorities with commercial land and property may invest in maximising its value, including repair, renewal and updating of the properties. This Strategy certifies that the Council's capital spending plans do not include the acquisition of assets primarily for yield.

4.45 **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.

4.46 **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. Our current strategy generally favours PWLB borrowing for long term debt due to ease of access to borrowing and certainty of low rates, however this is periodically reviewed with Arlingclose and when a decision for increased long-term borrowing is made all options will be scrutinised.

4.47 **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. The recent rise in interest rates means that more favourable debt rescheduling opportunities should arise than in previous years.

Borrowing Costs

4.48 Gross borrowing costs include interest payable and the statutory charge on the general fund for MRP. The borrowing costs associated with the 2023/24 to 2027/28 Capital Programme increase from £42m in 2022/23 to £91m by 2027/28.

4.49 Paragraph 1.18 of Annex 1 shows the ratio of gross borrowing costs against the net revenue stream (the amount funded from council tax, business rates and general government grants). Gross borrowing costs as a proportion of net revenue stream increases over the MTFS period from 4.1% in 2022/23 to 8.4% in 2027/28.

4.50 Net borrowing costs are calculated after offsetting interest and investment income and over the same period, net borrowing costs grow from £24m in 2022/23 to £69m in 2027/28.

4.51 Paragraph 1.19 of Annex 1 shows net borrowing costs against the net revenue stream increasing from 2.3% in 2022/23 to 6.4% in 2027/28.

4.52 Offsetting the increase in borrowing costs; many of the capital schemes are crucial to delivering revenue efficiencies, cost containment or income generation. After accounting for interest, investment and rental income to be generated by pipeline projects, net borrowing costs are projected to be contained within the budget envelope for the MTFS period.

Treasury Investment Strategy

4.53 The Council holds invested funds representing income received in advance of expenditure plus reserves. For the first half of 2022/23, the Council held average balances of £135m, compared with £58m for the equivalent period in 2021/22. The average return for the first half of 2022/23 was 1.17%. Cash balances are expected to reduce during the remainder of 2022/23 and over the MTFS.

4.54 **Objectives:** The CIPFA Code requires the Council to invest its treasury 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. The Council aims to be a responsible investor and will consider environmental, social and governance (ESG) issues when investing.

4.55 **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 reduce during 2023/24. 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.

4.56 While the Council's investment balances remain low (less than £150m), 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.

4.57 **ESG policy**: Environmental, social and governance (ESG) considerations are increasingly a factor in global investors' decision making, but the framework for evaluating investment opportunities is still developing and therefore the Authority's ESG policy does not currently include ESG scoring or other real-time ESG criteria at an individual investment level. When investing in banks and funds, the Authority will prioritise banks that are signatories to the UN Principles for Responsible Banking and funds operated by managers that are signatories to the UN Principles for Responsible Investment, the Net Zero Asset Managers Alliance and/or the UK Stewardship Code.

4.58 **Business models**: Under International Financial Reporting Standards (IFRS 9), the accounting for certain investments depends on the Council's "business model" for managing them. The 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.

4.59 **Approved counterparties**: The Council may invest its surplus funds with any of the counterparty types in Table 16 below, subject to the cash limits (per counterparty) and the time limits shown.

4.60 **Table 16 - 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.

4.61 **Minimum credit rating:** Treasury 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.

4.62 **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.

4.63 **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.

4.64 **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.

4.65 **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 or short notice liquidity and very low or no price volatility by investing in short-term money markets. They have the advantage over bank accounts of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a small fee. Although no sector limit applies to money market funds, the Council will take care to diversify its liquid investments over a variety of providers to ensure access to cash at all times.

4.66 **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.

4.67 **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 where practical. 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-.

4.68 **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 criteri a 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.

4.69 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.

4.70 **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.

4.71 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.

4.72 **Investment limits**: The Council's revenue reserves and balances available to cover investment losses are forecast to be approximately £102m on 31st March 2023, consisting of the Budget Equalisation Reserve, the Revolving Investment and Infrastructure Fund and the Interest Rate Reserve. There are currently no plans to draw down on these reserves in 2023/24. In practice, a default is highly unlikely. 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 17 – 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 (including Money Market Funds)	£25m per manager
Money Market Funds (Total)	Unlimited
Unsecured investments with Building Societies	£10m in total

4.73 **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 Prudential Indicators

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

4.75 **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%

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.

4.76 **Long-term treasury management investments:** 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 prudential limits on the long-term treasury management investments will be:

Price risk indicator	**2023/24**	**2024/25**	**2025/26**	**No fixed date**
Limit on principal invested beyond year end	£40m	£20m	£10m	£40m

Long-term investments with no fixed maturity date include strategic pooled funds and real estate investment trusts but exclude money market funds and bank accounts with no fixed maturity date as these are considered short-term.

Other Items

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

4.78 **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).

4.79 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.

4.80 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.

4.81 **Markets in Financial Instruments Directive**: The Council has opted in 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.

4.82 **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.

4.83 **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.

Knowledge and Skills

4.84 The Council employs professionally qualified and experienced staff in senior positions with responsibility for making capital expenditure, borrowing and investment decisions. The Council pays for officers to study towards relevant professional qualifications including CIPFA.

4.85 All officers involved in the treasury and investment management function have access to relevant technical guidance and training to enable them to acquire and maintain the appropriate level of expertise, knowledge and skills to undertake the duties and

responsibilities allocated to them. The Council currently employs treasury management advisors through Arlingclose (who commenced a new four-year contract from 1st January 2022) and seeks external legal and property related advice and due diligence as required. The Council's investment Strategy is supported by guidance from our advisors, Montagu Evans. The Council's Treasury Management and borrowing strategies are supported by guidance from our advisors, Arlingclose. Both are on hand to guide key decisions and provide proactive advice in response to emerging market trends.

4.86 Those charged with governance (Members of the Audit and Governance Committee and the Resources and Performance Select Committee) recognise their individual responsibility to ensure that they have the necessary skills to complete their role effectively. The Section 151 Officer will ensure that elected members tasked with treasury management responsibilities, including those responsible for scrutiny, have access to training relevant to their needs and responsibilities.

4.87 The Orbis partnership enables the creation and development of specialist resources. Centres of Expertise have been established for key areas of finance, and central teams of pooled expertise have been created to provide robust services which are resilient to meet the changing service needs of partners.

4.88 Where Council staff do not have the knowledge and skills required, use is made of external advisers and consultants that are specialists in their field. This approach is more cost effective than employing such staff directly and ensures that the Council has access to knowledge and skills commensurate with its risk appetite.

Financial Implications

4.89 The budget for cash investment income in 2023/24 is £1.5m, based on an average investment portfolio of £50m at an interest rate of 3%. The budget for debt interest paid in 2023/24 is £24.8m, which is based on a mix of short-term borrowing and the existing long-term fixed rate debt portfolio.

4.90 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
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 Indicators 2023/24

1.1 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.

1.2 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

1.3 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	**2022/23**	**2023/24**	**2024/25**	**2025/26**	**2026/27**	**2027/28**
	Projected	**← --------------------**	**Estimated**		**------------------------ →**	
	£m	**£m**	**£m**	**£m**	**£m**	**£m**
Capital programme expenditure (incl pipeline)	249	416	551	439	323	221
Approved investment strategy spend	1	26	2	3	0	0
Financed By:						
- Government grants and third party contributions	108	145	153	174	110	75
- Capital Receipts	0	41	20	13	2	0
- Revenue and reserves	6	7	6	6	6	6
Net financing need for the year*	**135**	**249**	**373**	**248**	**206**	**141**

*Capital expenditure to be met by borrowing

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

1.4 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).

1.5 The MRP is a statutory annual revenue charge which reduces the borrowing need in a similar way to paying principal off a household mortgage.

1.6 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.

1.7 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.

1.8 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 remains a 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)

	2022/23	2023/24	2024/25	2025/26	2026/27	2027/28
	Projected	← ------------------- Estimated ------------------- →				
	£m	£m	£m	£m	£m	£m
Opening CFR	1,339	1,446	1,662	1,992	2,190	2,340
Movements:						
- Minimum revenue provision	(24)	(29)	(38)	(45)	(51)	(56)
- Application of capital receipts to repay opening CFR	0	0	0	0	0	0
- PFI & finance leases	(4)	(5)	(5)	(5)	(5)	(5)
- Net financing need	135	249	373	248	206	141
	107	215	331	198	150	79
Closing CFR	**1,446**	**1,662**	**1,992**	**2,190**	**2,340**	**2,420**

<u>Gross borrowing and the capital financing requirement</u>

1.9 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.

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

The Council's operational boundary for external debt

1.11 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 (i.e. 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.

1.12 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.

1.13 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							
	2021/22	**2022/23**	**2023/24**	**2024/25**	**2025/26**	**2026/27**	**2027/28**
	Agreed	**Agreed**	**← ------------------**	**---------**	**Estimated**	**------------------**	**→**
	£m	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**
Borrowing	833	908	1,150	1,510	1,688	1,819	1,876
Other long term liabilities	91	87	82	77	73	68	63
Total	**924**	**994**	**1,232**	**1,588**	**1,761**	**1,887**	**1,938**
Estimated external debt	724	761	981	1,316	1,519	1,655	1,720

The Council's authorised limit for external debt

1.14 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.

1.15 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.

1.16 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.

1.17 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	2021/22	2022/23	2023/24	2024/25	2025/26	2026/27	2027/28
	Agreed	Agreed	← ----------	----------	Estimated	----------	---------- →
	£m	£m	£m	£m	£m	£m	£m
Borrowing	941	1,054	1,320	1,705	1,858	1,984	2,031
Other long term liabilities	91	87	82	77	73	68	63
Total	**1,032**	**1,141**	**1,402**	**1,782**	**1,930**	**2,052**	**2,094**
Estimated external debt	724	761	981	1,316	1,519	1,655	1,720

Estimated ratio of gross financing costs to net revenue stream

1.18 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.

	2021/22 Actual	2022/23 Forecast	2023/24 Forecast	2024/25 Forecast	2025/26 Forecast	2026/27 Forecast	2027/28 Forecast
Ratio of Gross Financing Costs to Net Revenue Stream	3.7%	4.1%	4.9%	6.0%	6.9%	7.7%	8.4%

Estimated ratio of net financing costs to net revenue stream

1.19 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 net financing costs (net of investment income).

	2021/22 Actual	2022/23 Forecast	2023/24 Forecast	2024/25 Forecast	2025/26 Forecast	2026/27 Forecast	2027/28 Forecast
Ratio of Net Financing Costs to Net Revenue Stream	1.6%	2.3%	2.9%	4.0%	4.8%	5.6%	6.4%

1.20 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 reserve.

Net income from commercial and service investments to net revenue stream

1.21 This is an indicator of affordability and highlights the net financial impact on the authority of its entire non-treasury investment income.

	2021/22 Actual	2022/23 Forecast	2023/24 Forecast	2024/25 Forecast	2025/26 Forecast	2026/27 Forecast	2027/28 Forecast
Total net income from service and commercial investments	21.3	18.5	20.1	21.1	21.3	21.3	21.3
Proportion of net revenue stream	2.1%	1.8%	1.8%	1.9%	2.0%	2.0%	2.0%

TMS Annex 2
Arlingclose Economic & Interest Rate Forecast – December 2022

2.1 **Underlying assumptions:**

- The influence of the mini-budget on rates and yields continues to wane following the more responsible approach shown by the new incumbents of Downing Street.
- Volatility in global markets continues, however, as investors seek the extent to which central banks are willing to tighten policy, as evidence of recessionary conditions builds. Investors have been more willing to price in the downturn in growth, easing financial conditions, to the displeasure of policymakers. This raises the risk that central banks will incur a policy error by tightening too much.
- The UK economy is already experiencing recessionary conditions and recent GDP and PMI data suggests the economy entered a technical recession in Q3 2022. The resilience shown by the economy has been surprising, despite the downturn in business activity and household spending. Lower demand should bear down on business pricing power – recent data suggests the UK has passed peak inflation.
- The lagged effect of the sharp tightening of monetary policy, and the lingering effects of the mini-budget on the housing market, widespread strike action, alongside high inflation, will continue to put pressure on household disposable income and wealth. The short- to medium-term outlook for the UK economy remains bleak.
- Demand for labour appears to be ebbing, but not quickly enough in the official data for most MPC policymakers. The labour market remains the bright spot in the economy and persisting employment strength may support activity, although there is a feeling of borrowed time. The MPC focus is on nominal wage growth, despite the huge real term pay cuts being experienced by the vast majority. Bank Rate will remain relatively high(er) until both inflation and wage growth declines.
- Global bond yields remain volatile as investors price in recessions even as central bankers push back on expectations for rate cuts in 2023. The US labour market remains tight and the Fed wants to see persistently higher policy rates, but the lagged effects of past hikes will depress activity more significantly to test the Fed's resolve.
- While the BoE appears to be somewhat more dovish given the weak outlook for the UK economy, the ECB seems to harbour (worryingly) few doubts about the short term direction of policy. Gilt yields will be broadly supported by both significant new bond supply and global rates expectations due to hawkish central bankers, offsetting the effects of declining inflation and growth.

Forecast:

- The MPC raised Bank Rate by 50bps to 3.5% in December as expected, with signs that some members believe that 3% is restrictive enough. However, a majority of members think further increases in Bank Rate might be required. Arlingclose continues to expect Bank Rate to peak at 4.25%, with further 25bps rises February, March and May 2023.
- The MPC will cut rates in the medium term to stimulate a stuttering UK economy, but will be reluctant to do so until wage growth eases. We see rate cuts in the first half of 2024.
- Arlingclose expects gilt yields to remain broadly steady over the medium term, although with continued volatility across shorter time periods.
- Gilt yields face pressures to both sides from hawkish US/EZ central bank policy on one hand to the weak global economic outlook on the other. BoE bond sales and high government borrowing will provide further underlying support for yields.

	Current	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25
Official Bank Rate													
Upside risk	0.00	0.50	0.75	1.00	1.00	1.00	1.25	1.50	1.75	1.50	1.25	1.25	1.25
Arlingclose Central Case	3.50	4.00	4.25	4.25	4.25	4.25	4.00	3.75	3.50	3.25	3.25	3.25	3.25
Downside risk	0.00	0.50	0.75	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.00	1.00
3-month money market rate													
Upside risk	0.00	0.50	0.75	1.00	1.00	1.00	1.25	1.50	1.75	1.50	1.25	1.25	1.25
Arlingclose Central Case	3.00	4.40	4.40	4.40	4.35	4.30	4.25	4.00	3.75	3.50	3.40	3.40	3.40
Downside risk	0.00	0.50	0.75	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.00	1.00
5yr gilt yield													
Upside risk	0.00	0.70	0.80	0.90	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Arlingclose Central Case	3.43	3.60	3.80	3.80	3.80	3.70	3.60	3.50	3.40	3.30	3.30	3.30	3.30
Downside risk	0.00	0.80	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
10yr gilt yield													
Upside risk	0.00	0.70	0.80	0.90	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Arlingclose Central Case	3.47	3.50	3.60	3.60	3.60	3.60	3.50	3.50	3.50	3.50	3.50	3.50	3.50
Downside risk	0.00	0.80	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
20yr gilt yield													
Upside risk	0.00	0.70	0.80	0.90	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Arlingclose Central Case	3.86	3.85	3.85	3.85	3.85	3.85	3.85	3.85	3.85	3.85	3.85	3.85	3.85
Downside risk	0.00	0.80	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
50yr gilt yield													
Upside risk	0.00	0.70	0.80	0.90	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Arlingclose Central Case	3.46	3.60	3.60	3.60	3.60	3.60	3.60	3.60	3.60	3.60	3.60	3.60	3.60
Downside risk	0.00	0.80	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00

PWLB Standard Rate (Maturity Loans) = Gilt yield + 1.00%

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

UKIB Rate (Maturity Loans) = Gilt yield + 0.60%

TMS Annex 3

Investment & Debt Portfolio Position as at 30 November 2022

	Actual Portfolio £m	**Interest Rate %**
External borrowing:		
Public Works Loan Board	458	3.60
Market	10	5.00
Local Authorities (Incl. Surrey Police)	111	1.89
Other	15	0.00
Total external borrowing	**594**	
Other long-term liabilities:		
Private Finance Initiative	91	
Total other long-term liabilities	**91**	
Total gross external debt	**685**	
Treasury investments:		
Banks & building societies (unsecured)	-	
Government (incl. Local Authorities)	-	
Money Market Funds	100	2.93
Total treasury investments	100	
Net debt	**585**	

TMS Annex 4

Glossary of Terms

CFR – Capital Financing Requirement

CIPFA – Chartered Institute of Public Finance Accountancy

CPI – Consumer Price Index

DLUHC – Department for Levelling Up, Housing and Communities

DMO – Debt Management Office

ECB – European Central Bank

GDP – Gross Domestic Product

LB – Liability Benchmark

MMF – Money Market Fund

MPC – Monetary Policy Committee

MRP – Minimum Revenue Provision

PWLB – Public Works Loan Board

TMSS – Treasury Management Strategy Statement

Annual Minimum Revenue Provision (MRP) Policy Statement 2023/24

1. The Council is required by statute to make a prudent provision for the repayment of its debt. It is also required to 'have regard' to guidance on how to calculate this provision, issued by the Department for Levelling Up, Housing and Communities (DLUHC). The Council has assessed the Minimum Revenue Provision and are satisfied that the guidelines for their annual amount of MRP, set out within this policy statement, will result in their making a prudent provision.

2. Where capital expenditure was incurred before 1 April 2008, the guidance suggests writing down the remaining Capital Financing Requirement by providing MRP of 4% per annum. The Council agreed in 2016/17 to write this amount off over the next 50 years, resulting in the whole balance being provided for over a finite period and far sooner than under the 4% reducing balance method.

3. As suggested in the guidance, for capital expenditure incurred on or after 1 April 2008 and funded through borrowing, the Council will calculate MRP by charging expenditure over the expected useful life of the relevant assets, on an annuity basis. MRP will be first charged in the year following the date that an asset becomes operational.

4. For the following types of capital expenditure, the Council has determined that an alternative methodology for determining the annual MRP charge should be adopted:

   - For assets acquired by finance leases or the Private Finance Initiative, MRP will be determined as being equal to the element of the rent or charge that goes to write down the balance sheet liability, or over the life of the asset.

   - Where loans are made to other bodies for their capital expenditure, e.g. subsidiaries of Surrey County Council, MRP is charged as with any other asset. This is a continuation of the policy adopted in 2022/23 to make MRP more prudent in response to fluctuating values of assets held within a subsidiary, following external audit recommendations and a Government consultation on potential changes to capital financing regulations.

   - MRP for investment property purchases is based on an estimated useful life of 50 years, on an annuity basis, in order to appropriately match MRP to the period of time that the assets are expected to generate a benefit to the Council. This is in recognition that these assets are held for income generation purposes and that the Council holds a saleable asset, the capital receipt from which will be used to repay any outstanding debt when sold.

   - The Council will determine MRP on equity investments based on a 20 year life. However, for equity investments in asset backed companies, a 50 year life will be assumed to match the Council's policy for investment assets.

5. The Council reserves the right to determine alternative MRP approaches in particular cases, in the interests of making prudent provision, where this is material, taking account of local circumstances, including specific project timetables and revenue-earning profiles.

6. Each year a new MRP statement will be presented.