Appendix 3

Borrowing Strategy and Indicators 2015/16

The capital expenditure plans of the council are set out in the Capital Programme Report approved by Policy & Resources Committee on 12 February 2015 and full Council on 3 March 2015. The treasury management function ensures that the Council's cash is organised in accordance with the relevant professional codes so that sufficient cash is available to meet the capital expenditure plans. This involves both the organisation of the cash flow and where required, the organisation of appropriate borrowing facilities.

As a response to the current economic climate, the Council has been following a strategy of repaying debt and funding its borrowing requirement through utilising cash balances which were supporting the Council's reserves and balances. This is a prudent strategy which has allowed the council to minimise the cost of carry on its borrowing, and reduce its counterparty exposure risk. However, this strategy cannot continue indefinitely as the reserves and balances will be gradually spent and the opportunity to borrow long term at historically low rates is declining. It will therefore be necessary to undertake new long term borrowing to bring down the level of council under-borrowing.

Opportunities have arisen in the financial markets for the council to enter into forward borrowing agreements where the council agrees to enter into a borrowing arrangement at a specified rate at a future date. Forward rate loans provide certainty over future costs whilst avoiding the cost of carry in the short term at a time when investment returns are still historically low. The budget shown in the medium term financial strategy has been prepared on the basis that £5m per year new forward rate long term borrowing is entered into in the four years from 2016/17 to 2019/20. This will gradually reduce the council's under-borrowing position, providing cash to underpin the planned spending of reserves within the Medium Term Financial Strategy. Interest rate forecasts will be closely monitored by Officers and the Treasury Advisors to ensure new borrowing is undertaken using the most appropriate instruments and at the time where market conditions are appropriate.

Table 1 below shows the net borrowing requirement (i.e. after allowing for provision to repay debt) and the level of reserves that is funding the borrowing requirement (under borrowing) over the next three years. The table demonstrates that the Council is currently funding its borrowing requirement with approximately £66.0m of reserves and balances and cashflows but this figure will decline in subsequent years. The 2015/16 budget uses certain reserves to meet one off costs, and this will reduce the availability of cash backed resources to fund the borrowing requirement increasing the need to borrow externally to ensure the availability of cash to meet these commitments. The 2015/16 budget includes a provision to enter into short term borrowing to fund this requirement until the first phase of new long term borrowing commences in 2016/17.

Table 1 – Projected borrowing requirement (excluding PFIs and other long term liabilities) and under borrowing position

	2014/15	2015/16	2016/17	2017/18
General Fund				
Borrowing Requirement - start of the year	160.1m	155.4m	152.1m	149.7m
Increase in borrowing requirement	5.9m	5.9m	6.9m	0.9m
Provision to repay debt	(10.6m)	(9.2m)	(9.3m)	(9.7m)

Borrowing Requirement - end of the year	155.4m	152.1m	149.7m	140.9m
Actual Borrowing	89.4m	98.4m	103.4m	109.4m
Under/(over) borrowing position	**66.0m**	**53.7m**	**46.3m**	**31.5m**
Housing Revenue Account				
Borrowing Requirement - start of the year	118.5m	116.6m	127.4m	136.7m
Increase in borrowing requirement	2.0m	13.8m	12.3m	1.9m
Provision to repay debt	(3.9m)	(3.0m)	(3.0m)	(0.5m)
Borrowing Requirement - end of the year	116.6m	127.4m	136.7m	138.1m
Actual Borrowing	116.6m	127.4m	136.7m	138.1m
Under/(over) borrowing position	**(0.0m)**	**(0.0m)**	**(0.0m)**	**(0.0m)**

Interest rate risk

The under borrowing position illustrated in Table 1 above demonstrates the extent to which the council is exposed to interest rate risk. As Appendix 2 outlines, borrowing rates have been historically low, and expected to rise in the medium term. Officers consider it prudent to amend the borrowing strategy and to consider forward rate borrowing in order to lock into low rates whilst minimising the cost of carry.

Officers will monitor market interest rates and adopt a pragmatic approach to changing circumstances in order to minimise the financial impact any adverse movement on interest rates on the Council's debt and investment portfolios;

- Long term borrowing will be postponed where it was felt there was a significant risk of a sharp fall in long term interest rates
- The borrowing position will be re-appraised and considered where it was felt that there was a significant risk of a sharp rise in long term interest rates with the likely action that new long term borrowing will be raised whilst interest rates are expected to be lower than in subsequent years.

Consideration will be given to the following borrowing options, which will be assessed appraised to seek the most appropriate option at the time:

- Short term borrowing (i.e. repayable for less than a year)
- PWLB variable rate loans for up to 10 years
- PWLB fixed rate loans up to 50 years
- Market loans that offer comparable or better terms to that set out above

The length and type of borrowing will depend upon factors including prevailing interest rates, interest rate expectations and the maturity profile of the council's existing portfolio.

Policy on Borrowing in advance of need

With long term fixed interest rates at risk of being higher over the next few years (see Table A, Appendix 2) Officers will consider the borrowing in advance of need. Any decision to borrow in advance will be within the forward approved Capital Financing Requirement estimates, and will be considered carefully to ensure value for money can be demonstrated and that the Council can ensure the security of such funds.

Risks associated with any borrowing in advance of activity will be subject to prior appraisal and subsequent reporting through the Treasury Management reporting process.

Debt Rescheduling

Table 2 shows the level of maturing debt over the next three years. The council has a number of loans where the lender may vary the interest rate, after which the council would have the right to repay. Based on the latest interest rate projections (Table A, Appendix 2), it is considered very unlikely that these loans would be repaid early – however, debt that is repaid early will have implications on both the GF and HRA debt portfolios.

	2015/16	2016/17	2017/18
Maturing Debt	£3.0m	£3.0m	£1.0m
Debt subject to early repayment options	£50.0m	£20.0m	£5.0m
Total debt at risk of maturity	£53.0m	£23.0m	£6.0m

Borrowing prudential Indicators

These indicators were approved as part of the budget report at full Council on 26 February 2015.

Limits to borrow activity

Prudential Indicators D1, D2 and D3 were approved as part of the Budget Report at full Council on 26 February 2015. These indicators set the limits of external borrowing

The operational boundary is the point at which external debt is not expected to be exceeded. The Authorised Limits is a control on the maximum level of borrowing, defined as the statutory limit under Section 3 (1) of the Local Government Act 2003. External debt is prohibited beyond the Authorised Limit and any revision to the limit would need approval by full Council.

Prudential indicators (D1) "Authorised limit" and (D2) "Operational boundary" 2015/16 to 2017/18

	2015/16 Estimate		2016/17 Estimate		2017/18 Estimate	
Authorised limit						
- Borrowing	£308m		£321m		£366m	
- Other l/term liabilities	£57m	£365m	£55m	£376m	£53m	£419m
Operational boundary						
- Borrowing	£319m		£332m		£377m	
- Other l/term liabilities	£57m	£376m	£55m	£387m	£53m	£430m

Separately, the Council is also limited to a maximum HRA CFR through the HRA self financing regime. This limit is currently:

Prudential indicators (D3) HRA Limit on indebtedness 2015/16 to 2017/18

	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate
HRA limit on indebtedness	£156.8m	£156.8m	£156.8m
HRA Debt	£126.6m	£136.0m	£137.3m
Headroom	£30.2m	£20.8m	£19.5m

Treasury management limits on activity

Prudential Indicators E2, E2a and E3 below are intended to manage the risk of adverse movement in interest rates and risk associated with refinancing maturing debt.

Prudential indicator (E2) – Upper limits on net debt interest rate exposure 2015/16 to 2017/18

	2015/16	2016/17	2017/18
Upper limit on fixed interest rate exposure	112%	111%	119%
Upper limit on variable interest rate exposure	45%	45%	45%

The percentages in Indicator E2 are calculated on the net outstanding principal sums (i.e. net of investments). The upper limit of 112% is a consequence of the council maintaining an investment portfolio. Indicator E2a exemplifies the indicator over borrowing and investment.

Prudential indicator (E2a) (supplemental) – Upper limits on interest rate exposure 2015/16 to 2017/18

	2015/16	2016/17	2017/18
Upper limit on borrowing – fixed rate exposure	100%	100%	100%
Upper limit on borrowing – variable rate exposure	40%	40%	40%
Upper limit on investments – fixed rate exposure	100%	100%	100%
Upper limit on investments – variable rate exposure	100%	100%	100%

Prudential indicator (E3) – Upper and lower limits on the maturity structure of borrowing 2015/16

	Upper limit	Lower limit
under 12 months	40%	0%
12 months and within 24 months	40%	0%
24 months and within 5 years	50%	0%
5 years and within 10 years	75%	0%
10 years and above	100%	40%