

Borrowing Strategy and Indicators 2018/19

The capital expenditure plans of the council are set out in the Capital Programme Report approved by Policy, Resources & Growth Committee on 08 February 2018 and full Council on 22 February 2018. 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.

The council operates a two pool approach for borrowing following HRA Self Financing introduced in March 2012.

General Fund Borrowing

As a response to the economic climate, the Council has been maintaining a strategy of repaying debt and funding its borrowing requirement through utilising cash balances which were supporting the Council's reserves and balances (known as under borrowing). This is a prudent strategy as investment returns are low and counterparty risk is still an issue that needs to be considered.

This strategy was amended in 2015/16 to reduce the council's under-borrowing position; £20 million of new borrowing was undertaken during 2015/16 and 2016/17 as a result of the expected reduction in cash backed resources due to the use of reserves expected to meet one-off costs within the medium term financial strategy. Undertaking this external borrowing has also allowed the council to take advantage of historically low interest rates, reducing the long term cost of the council's debt portfolio. The General Fund's average cost of borrowing as a result (excluding i360) has reduced from 4.82% to 4.46% which creates permanent revenue savings of £86,000.

The table below demonstrates that the General Fund expected to maintain approximately £45m of under-borrowing over the next three years. Borrowing interest rates have been volatile so far in 2017/18 and increased sharply after the result of the general election in June 2017, after the September MPC meeting, (when financial markets reacted by accelerating their expectations for the timing of Bank Rate increases), and again in January and February 2018. Increases have been sharper in periods up to 10 years than in longer maturities. The policy of avoiding new borrowing by running down spare cash balances has served well over the last few years. However, this needs to be carefully reviewed to avoid incurring higher borrowing costs in the future when the council may not be able to avoid new borrowing to finance capital expenditure and/or the refinancing of maturing debt.

There will remain a cost of carry to any new long-term borrowing that causes a temporary increase in cash balances as this position will, most likely, incur a revenue cost – the difference between borrowing costs and investment returns.

Major projects have not been included in this table due to the risk of uncertainty of timing of these projects requiring borrowing. Once timing is more certain for major projects approved within the capital programme, options appraisals will be undertaken to ascertain the most appropriate source and type of borrowing in each case.

Officers are currently exploring whether the council is able to access the PWLB's Infrastructure interest rate as announced as part of the Autumn Statement for eligible projects.

HRA Borrowing

The HRA operate a fully funded Capital Financing Requirement. In 2016/17, the HRA applied £13.3m of borrowing to fund its capital programme. Of this, it borrowed £10m externally from the PWLB and the remaining £3.3m was borrowed from the General Fund in order to reduce the HRA's interest rate and to also minimise counterparty risk at a time where general fund investment balances were increasing. Officers are monitoring interest rates in consultation with the treasury advisors to ascertain the optimum time to externalise this borrowing.

	2017/18 £'m	2018/19 £'m	2019/20 £'m	2020/21 £'m
General Fund				
Borrowing Requirement - start of the year	183.0	184.3	186.2	183.7
Increase in borrowing requirement	8.5	10.6	5.5	5
Provision to repay debt	(7.8)	(8.7)	(8.0)	(8.8)
Borrowing Requirement - end of the year	184.3	186.2	183.7	180.0
Actual Borrowing	139.0	140.5	140.8	141.1
Under/(over) borrowing position	45.3	45.7	42.9	38.8
Housing Revenue Account				
Borrowing Requirement - start of the year	123.1	127.3	146.1	150.1
Increase in borrowing requirement	4.7	19.7	4.8	
Provision to repay debt	(0.5)	(0.9)	(0.7)	(0.7)
Borrowing Requirement - end of the year	127.3	146.1	150.1	151.0
Actual Borrowing	127.3	146.1	150.1	151.0
Under/(over) borrowing position	0.0	0.0	0.0	0.0

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 3 outlines, borrowing rates have been historically low over year and expected to rise in the medium term.

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 is felt there is a significant risk of a sharp fall in long term interest rates;
- The borrowing position will be re-appraised and considered where it is felt that there is 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 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 the facilities set out above
- Bond issues by the Municipal Bonds Agency where they offer comparable or better terms than the other options outlined 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

The council will not borrow more than or in advance of its needs purely in order to profit from the investment of the extra sums borrowed. 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.

	2018/19	2019/20	2020/21
Maturing Debt	£2.7m	£2.4m	£2.4m
Debt subject to early repayment options*	£20.0m	£15.0m	£25.0m
Total debt at risk of maturity	£22.7m	£17.4m	£27.4m

As short term borrowing rates will be considerably cheaper than longer term fixed interest rates, there may be potential opportunities to generate savings by switching from long term debt to short term debt. However, these savings will need to be considered in the light of the current treasury position and the size of the cost of debt repayment (premiums incurred).

The reasons for any rescheduling to take place will include:

- the generation of cash savings and / or discounted cash flow savings;
- helping to fulfil the treasury strategy;
- enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

Consideration will also be given to identify if there is any residual potential for making savings by running down investment balances to repay debt prematurely as short term rates on investments are likely to be lower than rates paid on current debt.

All rescheduling will be reported to Policy, Resources & Growth Committee within the normal Treasury Management reporting process and/or Target Budget Management process following its action.

Municipal Bonds Agency

It is possible that the Municipal Bond Agency will be offering loans to local authorities in the future. The Agency hopes that the borrowing rates will be lower than those offered by the Public Works Loan Board (PWLB). This Authority may make use of this new source of borrowing as and when appropriate.

Borrowing prudential Indicators

The following borrowing indicators were approved as part of the budget report at full Council on 22 February 2017.

Limits to borrow activity

Prudential Indicators D1, D2 and D3 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) “Operational Boundary” and (D2) “Authorised Limit” 2018/19 to 2020/21

	2018/19 Estimate		2019/20 Estimate		2020/21 Estimate	
<u>Operational Boundary</u>						
- Borrowing	£373m		£414m		£444m	
- Other l/term liabilities	£50m	£423m	£48m	£462m	£45m	£489m
<u>Authorised Limit</u>						
- Borrowing	£386m		£428m		£458m	
- Other l/term liabilities	£50m	£436m	£48m	£476m	£45m	£503m

Separately, the council is also limited to a maximum HRA Capital Financing Requirement through the HRA self financing regime. This limit is currently £156.8 million.

Prudential indicators (D3) HRA Limit on indebtedness 2018/19 to 2020/21

	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate
HRA limit on indebtedness	£156.8m	£156.8m	£156.8m
HRA Debt	£146.1m	£150.1m	£151.0m
Headroom	£10.7m	£6.7m	£5.8m

Treasury management Indicators

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 2018/19 to 2020/21

	2018/19	2019/20	2020/21
Upper limit on fixed interest rate exposure	108%	108%	109%
Upper limit on variable interest rate exposure	43%	43%	43%

The percentages in Indicator E2 are calculated on the net outstanding principal sums (i.e. net of investments). The upper limit of 115% 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
2018/19 to 2020/21**

	2018/19	2019/20	2020/21
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
2018/19**

	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%