Appendix 2

Borrowing Strategy 2024/25 -2026/27

1. Background

1.1 Historically the Council has either been debt free or has had a very low-level of debt. This changed significantly in 2012 when, as part of the HRA reform, £265.9m of debt was transferred to the Council's HRA.

1.2 In January 2015, £89m was borrowed for the Council's General Fund (GF) from the European Investment Bank (EIB) to fund the regeneration of Abbey Road 2 and Gascoigne East (Weavers). Both schemes are now operational, bringing in sufficient income to cover the management and maintenance, lifecycle, capital, and interest costs, as well as generating income for the Council.

1.3 In November 2016, Cabinet approved the establishment of an Investment and Acquisition Strategy (IAS). The purpose of the IAS is to support the Borough's growth opportunities and to ensure that the Council, and future generations, benefit by increasing the Council's ownership of long-term income producing assets. The IAS is reviewed annually by Cabinet, with the next review to be taken to the April 2024 Cabinet. The IAS has an income target of delivering between £6.6m to £7.0m per year from 2020/21. This has been revised down for 2024/25 to 2026/27 to £5.2m. The IAS will be delivered primarily by the Council's development vehicle, Be First, and through its property companies, Reside.

1.4 The Council will ensure that all its investments are covered in the IAS and will set out, where relevant, it's risk appetite and specific policies and arrangements for non-treasury investments. It will be recognised that the risk appetite for these activities may differ from that for treasury management. The Council will set out a summary of existing material investments, subsidiaries, joint ventures and liabilities including financial guarantees and the Council's risk exposure.

1.5 To-date the Council has secured cheap long-term borrowing for current agreed IAS schemes (excluding Beam and 3b). There is still a £70m funding requirement for current schemes and £156m still required for Beam and GE3b. In addition, there remains refinancing for borrowing that has an annuity or equal instalment repayments. This will put a pressure on the interest rate budget and on lending rates as the current rate of around 5.0% is higher than the 2.0% average rate for long-term borrowing for the IAS. Short-term borrowing is higher than expected due to Welbeck and Pondfield not being sold (£75m), delays in taking long-term borrowing due to high interest rates and a lack of progress with Thames Road.

1.6 The refinancing is a risk to the Council but it should be noted that the average rate of the current long-term borrowing decreases over time, on a reduced balance and so the impact of higher refinancing is mitigated but not eliminated. The borrowing below is ringfenced for agreed schemes. Future borrowing for Beam, 3b and other schemes will have individual borrowing strategies to ensure the target rates (these are rates which are required to fund agreed schemes that the Council has not yet borrowed for) and borrowing profile can be linked.

1.7 In addition to borrowing, the Council has exposure to repayments through several leases, including Weavers Quarter (£85m), two leases linked to CPI (with cap & collars) for out-of-borough Hotels deals (£156m) and Trocoll (tbc).

Table 1: LBBD Historic Borrowing & Current Forecast (excl new schemes)

As at Date	General Fund LT Borrowing M's	General Fund ST Borrowing M's	Total GF Borrowing M's	HRA Borrowing M's	Total Borrowing M's	Cash M's	Total Net Borrowing M's
31/12/2011	- 40	- 10	- 50	-	- 50	92	42
31/12/2012	- 40	- 10	- 50	- 266	- 316	135	- 181
31/12/2013	- 50	- 12	- 62	- 266	- 328	108	- 220
31/12/2014	- 50	- 20	- 70	- 266	- 336	138	- 198
31/12/2015	- 129	- 66	- 195	- 266	- 461	258	- 203
31/12/2016	- 179	- 129	- 308	- 276	- 584	293	- 291
31/12/2017	- 268	- 121	- 389	- 276	- 665	301	- 364
31/12/2018	- 417	- 133	- 550	- 276	- 826	354	- 472
31/12/2019	- 506	- 141	- 647	- 276	- 923	335	- 588
31/12/2020	- 609	- 92	- 701	- 296	- 997	256	- 741
31/12/2021	- 729	- 55	- 784	- 296	- 1,080	225	- 855
31/12/2022	- 739	- 146	- 885	- 296	- 1,181	87	- 1,094
30/06/2023	- 755	- 143	- 898	- 300	- 1,198	46	- 1,152
31/12/2024	- 900	- 150	- 1,050	- 305	- 1,355	50	- 1,305
31/12/2025	- 1,000	- 100	- 1,100	- 305	- 1,405	50	- 1,355
31/12/2026	- 1,100	- 100	- 1,200	- 305	- 1,505	50	- 1,455

1.8 <u>Key Borrowing Risks</u>

Up to the end of 2021 cheap borrowing was absorbing most of the IAS scheme pressures caused by high build costs and low rent increases. In 2022 this trend ended suddenly with interest rates increasing in a short period of time, driven by inflation, which increased UK gilts, against which most of the Council's borrowing is linked to. This has continued into 2023 off the back of 14 consecutive base rate increases by the Bank of England in August 2023 to 5.25%. These pressures have been contained as the Council had already borrowed for the agreed IAS schemes and had a significant cash position. However, there are several key risks, both unavoidable and avoidable risks and these are outlined below:

1. **High Interest Rates** – interest rates have increased over the past two years. The 25-year gilts rate has increased from 0.95% in November 2021 to 4.12% in December 2022 and peaked at 5.2% in October 2023. PWLB rates are based on Gilts plus 0.8%, meaning rates have increased from 1.75% to nearly 6% for borrowing over a 25-year period. Rates have come off in November and December 2023 to around 4.1% but have subsequently increased in January 2024. The interest rate movements are highlighted in chart 1 below.

Chart 1: 25 Year Gilt Rates from 2011 to 2024

2. **Pipeline Schemes:** interest rate increases impacted on the agreed schemes, with the modelled borrowing rates for each proposed development increased to a peak of 6%. The impact of this has been to reduce the number of developments that can be agreed. Two large schemes with significant spend already incurred and where higher interest rates could be absorbed, were agreed in 2023/24, which increased borrowing but the rates that need to be borrowed at have also increased to cover the higher cost of borrowing.

   i. **Beam Park**

   In 2022 Beam Park was agreed by Cabinet. Increased build costs and further modelled interest rate increases, to 4.5% and 5%, made this scheme unviable in mid-2023. To make the scheme viable again required a change in tenure mix and the allocation of a significant amount of Right to Buy receipts. In addition, the commercial units in the proposal were removed. This enabled Beam to be agreed by Cabinet in September 2023 but has impacted the ability to use Right to Buy receipts for future schemes. Beam Park requires net borrowing of £114m, with £85m still required over the next two years.

   ii. **Gascoigne East Phase 3B (GE3b)**

   GE3b was agreed by Cabinet in October 2022 despite the scheme being unviable. The main reasons for the scheme being unviable was the provision of several large, social housing units, that are particularly difficult to make viable and increased interest rates. Several options to improve viability were recommended, including tenure changes, charging for service charges, using capital receipts for Realm and agreeing an improvement in operational costs. These were agreed and, in September 2023, Cabinet agreed the scheme. An interest rate of between 3% and 3.5% was used for the modelling GE3b, which is a challenging rate and will likely require cross subsidy from other schemes. GE3b requires net borrowing of £96m, with £71m still required over the next two years.

3. **Remaining Pipeline and Pre-Gateway 4 schemes**

   Several schemes have not been agreed but have had some work completed on them. There are currently viability issues with these schemes, but these are being addressed and there is the potential for these schemes to come to Cabinet in 2024 for agreement. These schemes are provided below and will require over three hundred million of funding:

1. Gascoigne East Phase 2 Block E1	4. Jervis Court
2. Padnall Lake Phase 3	5. Gascoigne West Phase 3
3. Brocklebank	6. Church Street.

While interest rates are high, to ensure agreed schemes are modelled prudently, a cost of borrowing level of between 5% to 6% will be required, which will make viability extremely difficult. Options around sales, joint ventures and tenure changes will also be reviewed.

1.9 <u>Capitalisation of Development Interest</u>

The Council's IAS has increased the Council's interest payment costs. Were the Council to borrow a billion pounds at 5.0% (the current long-term debt rate) then the interest costs would be £50m per year, although this would decrease as debt is repaid. This will be funded by rental income from the various schemes. The rate of 5.0% is more than double the average borrowing rate the Council has managed to secure for current, agreed schemes and represents a significant viability hurdle.

During the construction stage there is a cost of carry as there is no income generated from the scheme. Interest incurred during the construction phase is capitalised against developments that cost over £10m and that take in excess of two years to build. Capitalisation of interest starts from when the development has been agreed at Gateway 2. Where land has been purchased as part of land assembly the capitalisation of interest will be from the later date of the either the completion date of the purchase or the date of this accounting policy. Interest will be capitalised quarterly and is based on the weighted average borrowing costs. Cessation of capitalisation will occur when the scheme is operational.

As part of the Treasury outturn report, an outturn figure for interest that was capitalised for the year, is provided to Members.

2. The Council's Borrowing Strategy

2.1 The decision to borrow is a treasury management decision and is taken by the Investment Fund Manager (IFM), after agreement by the S151 Officer under delegated powers of the Council's constitution. The key objective of the Council's borrowing strategy is to secure long-term funding for capital projects and IAS at borrowing rates that are as low as possible.

2.2 Currently the Council has a hollistic approach to borrowing, taking into account cashflow, borrowing costs and investment and loan returns to drive the net cost of borrowing down, while keeping the borrowing transparent and simple.

2.3 The Council can borrow funds from the PWLB, capital markets, bond issuance and other local authorities. The Council borrows for several purposes, including:

(i) *Short term temporary* borrowing for day-to-day cash flow purposes.
(ii) *Medium term borrowing* to cover construction and development costs.
(iii) *Long-term borrowing* to finance the capital and IAS programme.

2.4 The IFM will monitor interest rates and will recommend borrowing decisions when rates are low, while taking into account the Council's debt repayment profile and cashflow requirements. The Council's borrowing strategy will give consideration to the following when deciding to take-up new loans:

- Use internal cash balances;
- Short-term borrowing from other Local Authorities;
- Using PWLB, the EIB or financial Institutions;
- Ensure new borrowings are drawn at suitable rates and periods;
- Consider the impact of grant and sales on long term borrowing; and
- Consider the issue of stocks and bonds if appropriate.

2.5 Based on current agreed schemes, 2024/25 to 2026/27 a significant amount of borrowing is still required, with the main borrowing required to fund the IAS but also as part of refinancing annuity and Equal Instalment Repayments, short-term borrowing, as well as the reduced cash position if reserves are used to fund Council shortfalls.

2.6 Currently new borrowing is short-term to keep the average long-term borrowing rate low. Most new borrowing is to fund the IAS and therfore the increased borrowing cost is currently capitalised against the various projects. This has resulted in an increase in the scheme costs but has not been a charge to revenue, but it will have a greater impact, if rates remain high, when schemes are completed and the captialsied interest ends and is replaced by a loan to Reside.

2.7 Officers are closely monitoring the cost of borrowing and have increased the scheme financial models to include higher borrowing costs during the development period as well as on-lending rates.

2.8 A summary of the borrowing required for IAS to for 2023/24 to 2026/27 is below:

IAS (net costs)	2023/24	2024/25	2025/26	2026/27	Total
	£000s	£000s	£000s	£000s	£ms
Residential	275,182	157,493	111,699	18,708	563,082
Commercial	16,446	4,096	2,000	1,000	23,542
Section 106 / CIL	0	0	-1,500	-1,762	-3,262
Capital Receipt	-64,434	-64,031	-12,863	-94,527	-235,855
Total IAS Borrowing	**227,195**	**97,557**	**99,337**	**-76,581**	**347,507**

2.9 Excluding pipeline schemes, the borrowing required will take the Councils total CFR to over £2bn by 2025/26. Although the assets being purchased and built with this borrowing are in-borough and mainly residential, this exposure, especially considering the decline in investment returns and increase in cost of borrowing, needs to be reviewed from both a risk exposure but also capacity.

2.10 Capacity issues have already been experienced with recent handovers, with letting and management of the assets underperforming assumptions and benchmarks. It is also important for Members to be aware that there are assumptions in the financial models, around costs, rent collection, maintenance and lifecycle costs that are challenging and need to be achieved for the schemes to provide a return and if these are not met then returns will be lower than forecast, with current forecasts already marginal.

3. Council's Current Debt

3.1 The Council currently (at 30/11/2023) has £1.27bn of debt at an average rate of 2.90% and average duration of 22.7 years. The Council's General Fund (GF) debt is £963.9m at an average rate of 2.73% and an average duration of 19.75 years. This is broken down as follows, with the comparator figures as at 31 December 2022:

	Principal £000s	Return %	Average Life (yr)	Principal £000s	Return %	Average Life (yr)
General Fund Fixed Rate Long Term Borrowing						
PWLB	617,887	1.91%	28.59	600,692	1.91%	28.00
European Invest. Bank	74,220	2.21%	20.35	71,563	2.21%	20.35
L1 RENEWABLES	6,752	3.44%	22.85	6,711	3.44%	22.85
DEXIA BANK LOBO	10,000	3.98%	53.62	10,000	3.98%	53.62
Total GF Debt	**708,859**	**1.99%**	**28.02**	**688,967**	**1.99%**	**27.53**
General Fund Fixed Rate ST Borrowing						
Local Authority ST	**146,228**	**2.99%**	**- 0.79**	**254,980**	**4.77%**	**0.19**
GF Medium Term Borrowing	**30,000**	**0.77%**	**0.72**	**20,000**	**2.43%**	**1.46**
Total GF ST / MT Borrowing	**176,228**	**2.61**	**0.38**	**274,980**	**4.60%**	**0.28**
Total GF Debt	**784,382**	**1.85**	**26.83**	**963,946**	**2.73%**	**19.75**
HRA Borrowing						
PWLB Fixed Rate	265,912	3.50%	32.14	265,912	3.50%	32.14
Market Loans Fixed Rate	30,000	4.03%	42.07	30,000	4.03%	42.07
HRA Internal Borrowing Variable Rate				10,704	4.73%	-
Total HRA Debt	**295,912**	**3.55%**	**33.15**	**306,616**	**3.43%**	**31.99**
Total Borrowing	1,180,999	2.47%	25.04	**1,270,562**	**2.90%**	**22.71**

3.2 <u>General Fund Debt</u>

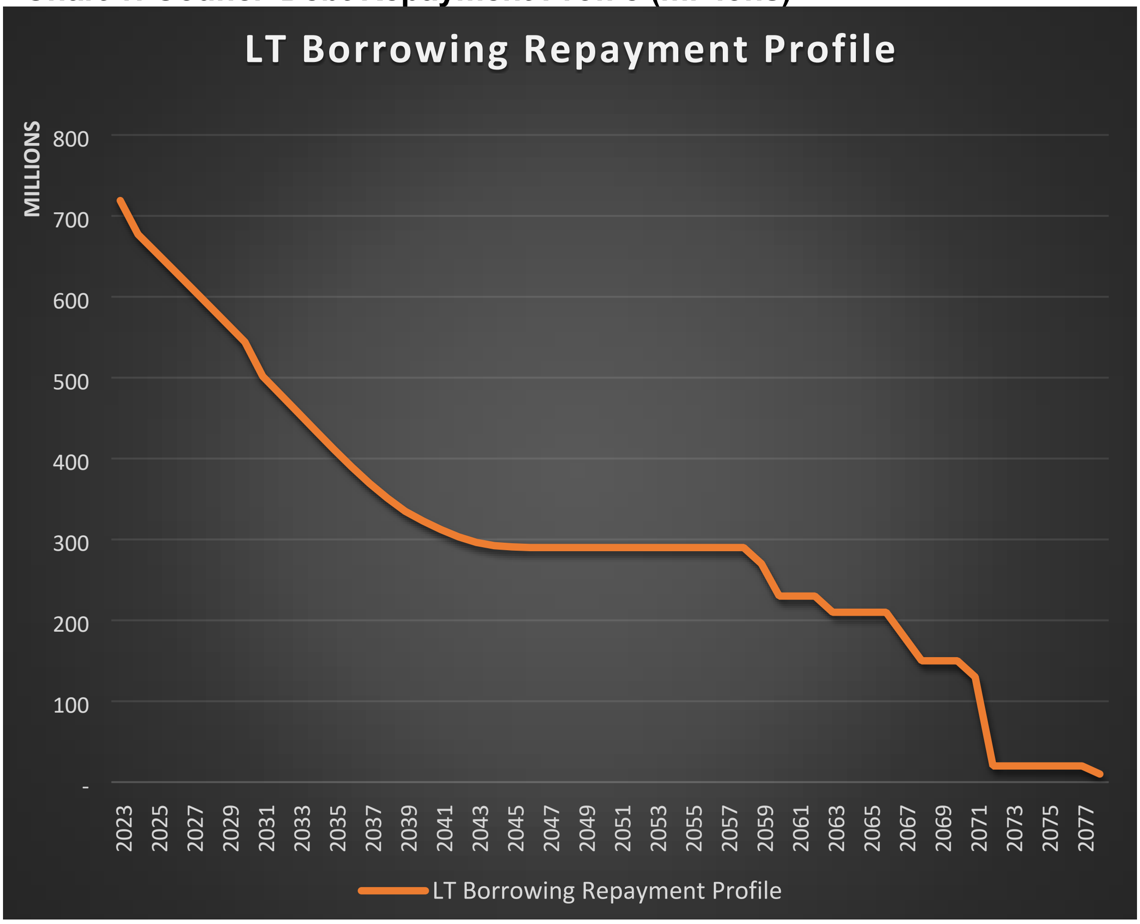
The GF debt can be split into short and long-term borrowing. Short-term borrowing is used to manage the Council's daily cash requirements and allows treasury to make strategic, longer term borrowing decisions while keeping the cost of carry low. It is also used to fund short-term commercial holdings. Annual long-term borrowing amounts are summarised below:

Year	Amount	Reason for Borrowing
Pre-2015	10	Capital Expenditure
2015	89	Abbey Road 2 & Gascoigne East Regen
2016	60	Film Studio Land
2017	120	Borrowing for Street Purchases and IAS
2018	150	IAS
2019	140	IAS
2020	60	IAS

2021	140	IAS
2022	176	IAS - mainly short and medium term
2023	80	IAS - mainly short term
Various	-61	Borrowing Repaid
Total	**964**	

Although the borrowing is long-term, a part of the Council's debt is repaid each year through annuity or equal instalment repayment. As a result, the Councils debt repayment profile is relatively smooth, as outlined in the chart below. Future borrowing will be mapped against this repayment profile and the forecast cashflows to help refinancing risk but also allow for a steady reduction in the Council's debt exposure. The chart below also shows the Council's borrowing repayment profile for long-term borrowing as at 30 November 2023:

Chart 1: Council Debt Repayment Profile (millions)



3.3 <u>General Fund Interest Costs</u>

Currently the average long-term interest rate on GF borrowing is 1.99% for £708.9m borrowed. This rate drops steadily to 1.64% in 2070 but on a reduced balance, as borrowing is repaid. The average rate for the duration is 1.92%.

3.4 <u>Borrowing from Financial Institutions</u>

Treasury officers will generally borrow from the PWLB when rates are low. However, where cheaper or more appropriate borrowing is available from other financial institutions then this is used as an additional source of financing. With the PWLB margin 0.8% above Gilts, this provides an excellent source of finance to support the Council regeneration strategy.

Currently the following loans have been borrowed from financial institutions:

i. European Investment Bank (EIB) Borrowing: In 2014/15 Cabinet agreed to borrow £89m from the European Investment Bank (EIB) as outlined below:

- £66m from the EIB to finance the Gascoigne Estate (East) Phase 1;
- £23m from the EIB to finance Abbey Road Phase 2.

The drawdown of the full £89m was completed on 30 January 2015 at a rate of 2.207% and currently the balance owed is £71.6m. The EIB loan does contain financial covenants that restrict to the Council's overall investment strategy. In 2021/22 discussions were held with the EIB to increase the financial covenants of the EIB loan. These discussions have resulted in a significant increase in the covenant limits, as outlined below but also resulted in the interest rate from the EIB increasing by 1 basis point to 2.217% and a fee of £27,597.86 was payable:

i. the Total Debt shall not exceed 150% of Operating Revenues;
ii. Financing Costs shall not exceed 10% of Operating Revenues;
iii. Liquid Assets should be at least 1.2 times Short-term debt; and
iv. Debt Service shall not exceed 10% (ten percent) of Operating Revenue.

ii. Green Investment Bank (GIB) Borrowing (now L1 Renewables)

At its meeting on 2 December 2015 the Council agreed to borrow £7.5m from the GIB to finance the Low Energy Street Light Replacement Programme via the UK GIB Green Loan. On 15 December 2016, a loan of £7.0m was borrowed from the GIB at a rate of 3.44% for a duration of 30 years. The borrowing drawdown period will be over a two-and-a-half-year period and will match the forecast expenditure. The repayment of the loan has been structured to best match the cashflows expected to be generated from the energy savings.

3.5 HRA Self Financing

The Council uses a two loans pool approach for long-term debt. The £265.9m of PWLB is from the HRA reform in 2012, with an additional £30m of borrowing transferred to the HRA in 2016 and 2020 to finance HRA new builds. The HRA previously had a debt cap of £291.60 but this was removed in 2018. A breakdown of the HRA borrowing is provided in table 5 below:

Loan Type	Loan Amount	Maturity profile	Interest Rate
	£'000s	Yrs.	%
PWLB	50,000	24	3.51
PWLB	50,000	34	3.52
PWLB	50,000	42	3.49
PWLB	50,000	43	3.48
PWLB	65,912	44	3.48
Barclays	10,000	60	3.98
Phoenix Life	20,000	40	4.05
Total	**295,912**		

4. Repayment of Borrowing

As short term borrowing rates are usually 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, any savings will need to be based on 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; and
- enhance the balance of the portfolio (amend the maturity profile).

Internal borrowing can also be reduced by generating capital receipts, which will replenish cash balances and in accounting terms be used for financing historic spend rather than for new capital projects.

5. 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 forward approved CFR estimates, and will be considered carefully to ensure that value for money can be demonstrated and that the Council can ensure the security of such funds.

Risks associated with any borrowing in advance activity will be subject to prior appraisal and subsequent reporting through the mid-year or annual reporting mechanism.