

Borrowing Strategy 2018/19

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. Abbey Road 2 is currently operational, bringing in sufficient income to cover the capital and interest costs, as well as generating income for the Council. Gascoigne East will be operational in 2018.
- 1.3 In November 2016, Cabinet approved the establishment of an Investment and Acquisition Strategy (IAS). Cabinet also approved an initial £250m investment budget and £100m land and property acquisition budget to support delivery of the 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.
- 1.4 The IAS has an income objective and a target of delivering £5.12m by 2020/21. The IAS will be delivered primarily by the Council's development vehicle, Be First, and it is expected that Be First will accelerate the regeneration of the borough.
- 1.5 The IAS will support the Council to fundamentally change its approach to investment and regeneration. Going forward the Council will become a proactive developer and investor, helping to support growth opportunities and ensure that the Council and future generations benefit by increasing its ownership of long-term income producing assets. Potentially 44 schemes are in the pipeline over a period of 15 years, with the total capital expenditure estimated at over £2bn, were the whole programme funded by the Council. Whilst the Council will use, where possible, capital receipts it generates from land sales to help finance acquisition costs, the main source of financing of the full programme will be from borrowing.
- 1.6 It is expected that the net capital expenditure required, which is the capital spend less any money received from private sales and shared ownership, will be significantly less than £2.0bn. There may also be occasions where refinancing may be used to secure borrowing on the properties when they are operational and in some cases properties will be sold to fund new regeneration schemes.
- 1.7 Due to the scale of the regeneration programme borrowing from the Public Works Loan Board (PWLB) will be considered, especially when rates are low, as will institutional funders such as the EIB. In addition, it may be more advantageous to raise finance through the issuance of a bond or seek funding from the capital markets. A range of borrowing periods will also be used based on cashflow requirement, ensuring that not all borrowing is long term and that the debt repayment is linked to the income generated from both the rental returns and the sales receipts.

- 1.8 It is important to highlight that the Council's IAS will increase the Council's interest payment costs significantly. Were the Council to borrow a billion pounds at 2.5% then the interest costs would be £25m per year. Although this will be funded by rental income from the various schemes, this will still result in a long-term obligation on future generations as some of the loans that will be taken out have maturity dates of 50 years.
- 1.9 An additional consideration is the cost of borrowing during the construction phase. Borrowing costs are high during the construction period as there are still borrowing costs but no income coming in from the scheme. Short-term borrowing, structured borrowing and cross subsidising from other schemes will reduce the impact of this but there will remain a financing and interest rate risk during this period.
- 1.10 The Council recognises that investment in other financial assets and property primarily for financial return and taken for non-treasury management purposes, requires careful investment management. Such activity includes loans supporting service outcomes, investments in subsidiaries, and investment property portfolios.
- 1.11 The Council will ensure that all its investments are covered in the IAS and will set out, where relevant, its 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.
- 1.12 The Council will maintain a schedule setting out a summary of existing material investments, subsidiaries, joint ventures and liabilities including financial guarantees and the Council's risk exposure. This schedule will be part of a capital strategy developed in response to the revised Prudential and TM Code requirements

2. The Council's Borrowing Strategy

- 2.1 The decision to borrow is a treasury management decision and is taken by the COO under delegated powers of the Council's constitution and after consultation with the Group Manager – Treasury and Pensions and the Director of Finance. 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 holistic approach to borrowing, taking into account cashflow, borrowing costs and investment returns to drive the net cost of borrowing down, while keeping the borrowing transparent and relatively easy to understand. This holistic approach has resulted in very low net borrowing costs, with the 2017/18 net interest budget of £2m supporting £245m of General Fund long term borrowing. This equates to a net cost (interest payments less interest income) of 0.81% for an average duration of approximately 41 years. While it will not be possible to keep borrowing costs this low for future borrowing, this holistic approach will be maintained, with transparency a key driver behind any borrowing decision.

2.3 The Council can borrow funds from the PWLB, from capital markets, from bond issuance and from other local authorities. The Council would look to borrow 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 In 2018/19 a significant amount of borrowing is required. The COO and treasury section will monitor interest rates and, where possible, make 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;
- Using PWLB, the EIB or Local Authorities for fixed term loans;
- Using Institutional investors (Pension Funds and Insurance Companies);
- Ensure new borrowings are drawn at suitable rates and periods; and
- Consider the issue of stocks and bonds if appropriate.

2.5 The Council has £30m of fixed rate Lender's Options Borrower's Option (LOBO) loans and all of them will be in their call period during 2018/19. A LOBO is called when the Lender exercises its right to amend the interest rate on the loan at which point the Borrower (the Council) can accept the revised terms or reject them and repay the loan. LOBO loans present a potential refinancing risk to the Council since the decision to call a LOBO is entirely at the Lender's discretion. Any LOBO called will have the default position of repayment of the LOBO without penalty, i.e. the revised terms will not be accepted.

3. Council's Current Debt

3.1 The Council currently has £665.1m of debt at an average rate of 2.49%. This can be broken down as follows:

Borrowing	Amount Borrowed £'000s	Average Rate of Borrowing
General Fund		
LOBO	30,000	4.03
Local Authority (Medium-Term)	19,000	0.97
Local Authority (Short-term)	120,550	0.33
Market Loan	89,655	2.25
PWLB	130,000	2.37
Total General Fund Borrowing	389,205	1.77
HRA		
LOBO	10,000	3.98
PWLB	265,912	3.50
Total HRA Borrowing	275,912	3.51
Total Council Borrowing	665,117	2.49

3.2 General Fund Debt

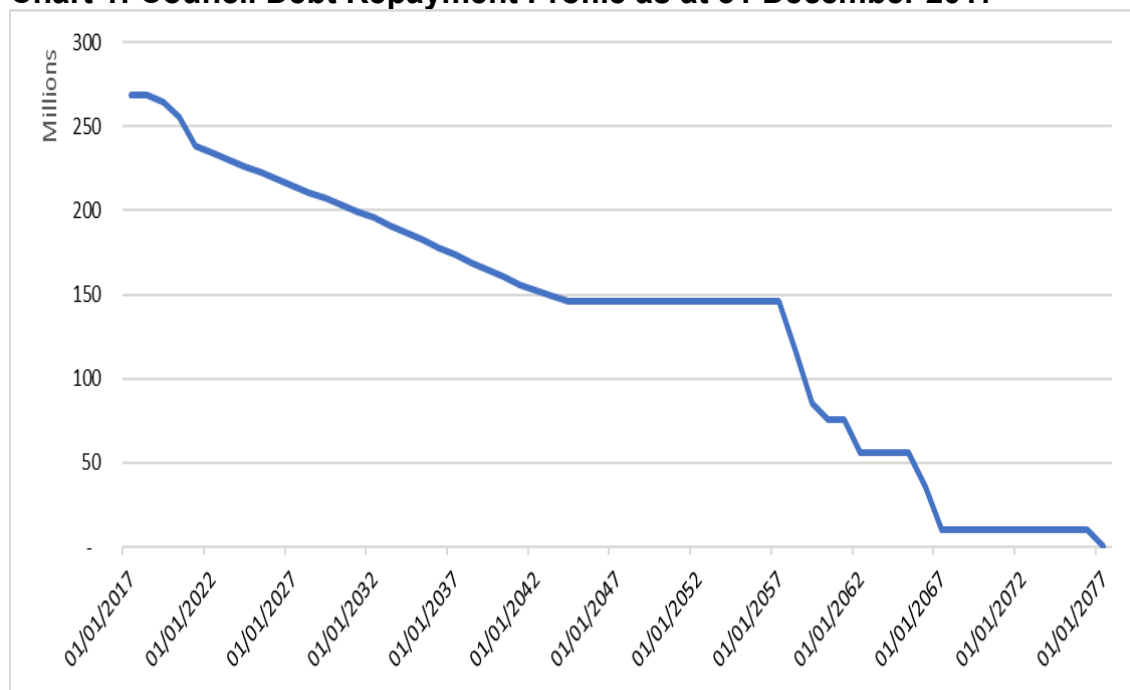
The GF debt can be split into Short-Term borrowing and Long-Term borrowing. Short-term borrowing is used to manage the Council daily cash requirements and to allow the Council to make strategic, longer term borrowing decisions without a significant impact from the cost of carry.

Long-term borrowing has historically been used to fund the Council's capital expenditure but is now mainly used to fund the Council's IAS. The Council first borrowed over a long-term period in 2008, with more significant borrowing in the past three years. While borrowing is not attributed to specific projects, the following are substantial elements of the capital programme:

Year	Amount	Reason for Borrowing
Pre-2015	£30m	Borrowing for Capital Expenditure
2015	£89m	Borrowing for Abbey Road and Gascoigne East Regen.
2016	£59m	Borrowing for Land and Property Acquisition
2017	£90m	Borrowing for Street Purchases and Acquisitions
Total	£268m	

Although the borrowing is long-term, a large part of the Council's debt is repaid each year through either an annuity repayment or equal instalment repayment. As a result, the Council's 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.

Chart 1: Council Debt Repayment Profile as at 31 December 2017



3.3 Borrowing from Financial Institutions

The treasury section 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.

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%.

- 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.

3.4 HRA Self Financing

The Council uses a two loans pool approach for long term debt. The £265.9m of PWLB long-term debt from the HRA reform is allocated to the HRA. A breakdown of the HRA borrowing is provided in table 5 below:

Table 5: HRA borrowing:

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
Total	275,912		

The HRA debt cap is currently set at £278m; however, the Council has been given approval from the DCLG to exceed this by £13.95 making the new total cap £291.60 onwards from 2018/19.

4. Repayment of Borrowing

- 4.1 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).
- 4.2 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).
- 4.3 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

- 5.1 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.
- 5.2 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.