Appendix 2

Borrowing Strategy 2021/22 to 2023/24

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), with an initial £350m 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. The IAS is reviewed annually by Cabinet, with the next review to be taken to the March 2021 Cabinet.

1.4 The IAS has an income objective and a target of delivering £5.72m 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 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.

1.6 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.

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

1.7.1 The Council's IAS will increase the Council's interest payment costs. Were the Council to borrow a billion pounds at 2.0% (the current target average long-term debt rate) then the interest costs would be £20m per year, although this would decrease as debt is repaid. This will be funded by rental income from the various schemes but will result in a long-term obligation for future generations as some of the loans that will be taken out have maturity dates of up to 50 years.

1.7.2 The Council's borrowing is largely to fund its IAS, which includes a number of large-scale developments. During the construction stage there is a cost of carry as there is no income from the scheme. To reduce this cost, from 1 April 2019, interest incurred during the construction phase will be capitalised against developments that cost over £10m and that take in excess of two years to build.

1.7.3 Capitalisation of interest will start 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.

1.7.4 Interest will be capitalised on a quarterly basis and will be based on the weighted average of the borrowing costs that are outstanding during the period. Cessation of capitalisation will occur when substantially all the activities necessary to prepare the qualifying asset for its intended use are complete.

1.7.5 As part of the Treasury outturn report, an outturn figure for the amount of interest that was capitalised for the year, will be 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 S151 Officer under delegated powers of the Council's constitution and after consultation with the Investment Fund Manager (IFM). 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. This hollisitc approach has resulted in very low net borrowing costs, with the 2019/20 net interest budget of £5.1m supporting £608.65m of GF long term borrowing. This equates to a net cost (interest payments less interest income) of 0.84% for an average duration of approximately 31 years.

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 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; and
- Consider the issue of stocks and bonds if appropriate.

2.5 In 2021/22 to 2023/24 a significant amount of borrowing is required, with the main borrowing required to fund the IAS. The borrowing requirments include for schemes that have been agreed and are in various stages of devlopment and also pipeline schemes that have not been agreed but are included in the Be First

Business Plan. A summary of the borrowing requirement for the IAS to 2023/24 and then the total forecast borrowing forecast for the Council is below:

Investment and Acquisition Strategy (net costs)	2020/21 £000s	2021/22 £000s	2022/23 £000s	2023/24 £000s
Committed Funding Requirement	271,845	388,813	351,152	140,106
Potential Funding Requirements	6,455	174,434	151,548	180,296
Total Net Borrowing Requirement	**278,300**	**563,247**	**502,700**	**320,402**
Total Accumulative Borrowing	**1,140,465**	**1,616,825**	**2,090,630**	**2,461,717**

2.6 An increase from a debt rate of approximately £1bn by the end of 2019/20 to nearly £2.5bn potentially by £2023/24 is a significant increase in borrowing. With borrowing rate currently at historic lows, it will be essential to lock in these low rates. This level of borrowing will also have an impact on managing the increase in cash held resulting from the borrowing.

3. Council's Current Debt

3.1 The Council currently (as at 31/12/2020) has £996.57m of debt at an average rate of 2.37% and average duration of 26.6 years. This is broken down as follows:

	Principal £000s	Return %	Average Life (yrs.)
General Fund Fixed Rate Long Term Borrowing			
PWLB	512,490	2.06	25.83
European Investment Bank	79,363	2.21	23.30
DEXIA BANK LOBO	10,000	3.98	56.50
L1 RENEWABLES	6,803	3.44	25.76
Total General Fund Debt	**608,656**	**2.13**	**26.00**
General Fund Fixed Rate Short Term Borrowing			
Local Authority Short Term	92,000	0.20	0.11
Total GF Debt	**700,656**	**1.87**	**22.60**
HRA Fixed Rate Borrowing			
PWLB	265,912	3.50	35.10
Market Loans	30,000	4.03	44.96
Total HRA Debt	**295,912**	**3.55**	**36.06**
Total Council Borrowing	**996,568**	**2.37**	**26.60**

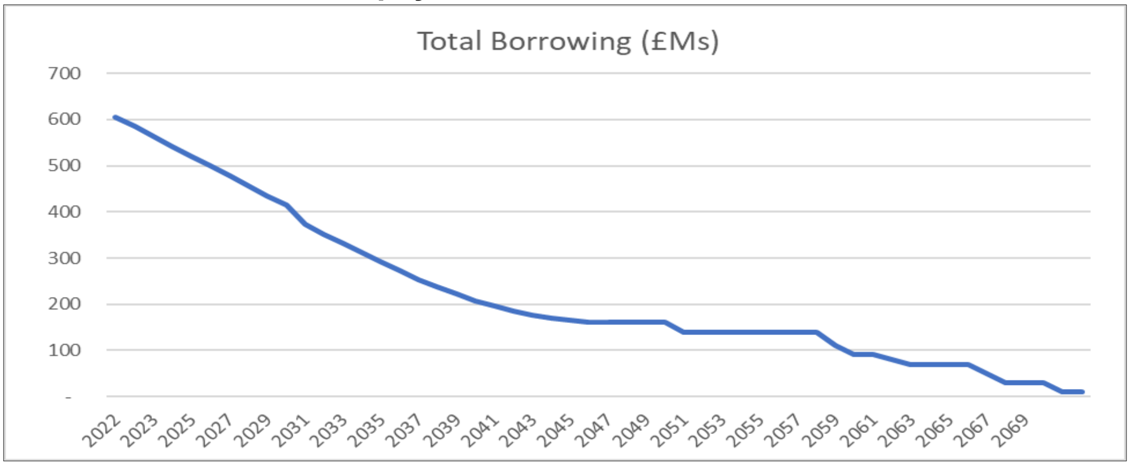
3.2 General Fund Debt

The GF debt can be split into Short and Long-Term borrowing. Short-term borrowing is used to manage the Council daily cash requirements and allows treasury to make strategic, longer term borrowing decisions without a significant impact from the cost of carry. Annual long-term borrowing amounts are summarised below:

Year	Amount	Reason for Borrowing
Pre-2015	30.0	Capital Expenditure
2015	89.0	Abbey Road 2 and Gascoigne East Regen (Weavers)
2016	60.0	Film Studio Land and IAS
2017	120.0	Street Purchases and IAS
2018	150.0	IAS
2019	140.0	IAS
2020	60.0	IAS
Various	(40.3)	Borrowing Repaid
Total	**608.7**	

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

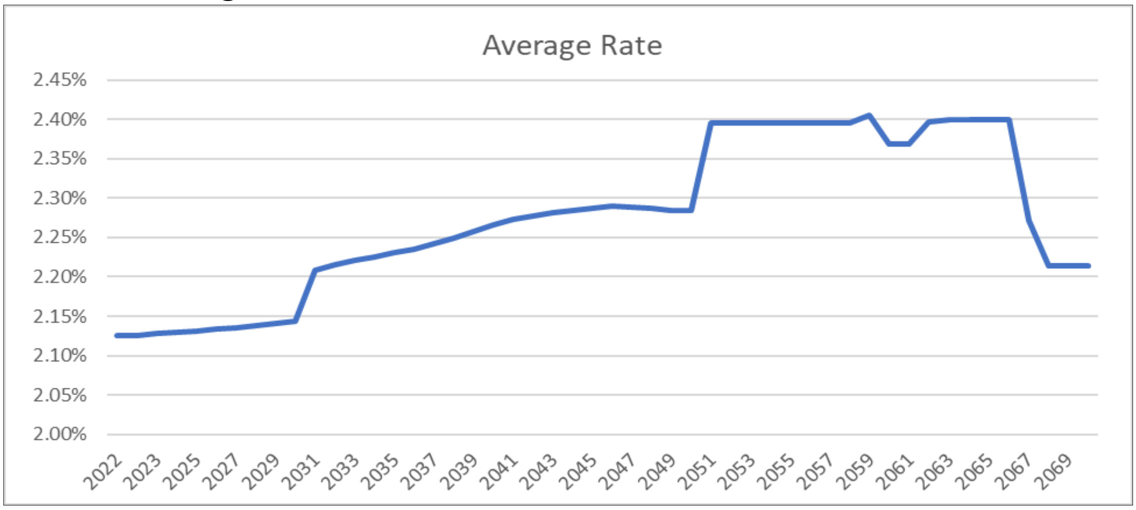
Chart 1: Council Debt Repayment Profile as at 31 December 2020



3.3 General Fund Interest Costs

Currently the average long-term interest rate on borrowing is 2.13% for £608.7m borrowed. However, this rate increases to 2.4% by 2051 but on a reduced balance of £140m, as cheaper borrowing is repaid and older (borrowed when rates were higher), more expensive borrowing remains. The rate drops to 2.21% in 2068 but this is on a remaining balance of £30m. The average interest rate to 2070 is provided in chart 2 below:

Chart 2: Average Interest Rate to 2070



Utilising short-term borrowing does reduce the average rate to 1.87% but this is just for the current year, with the short-term borrowing being used for strategic purposes. The interest rate forecast is for rates to stay low for the next few years and there is a target to reduce the long-term average borrowing to below 2%.

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. With the PWLB margin back to 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 £79.4m. The EIB loan does contain financial covenants that may be restrictive to the Council's overall investment strategy. Discussions are being held with the EIB to seek to review the financial covenants or potentially to refinance the borrowing through an early repayment and refinancing through the PWLB.

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 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
Lancashire CC	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.