



Cabinet
12 September 2018

Report from the Chief Finance Officer

Appendix A: Brent Council Borrowing Strategy 2018/19 – 2020/21

Wards Affected:	All
Key or Non-key Decisions	Key
Open or part/fully exempt: (If exempt, please highlight relevant paragraph of Part 1, Schedule 12A of 1972 Local Government Act)	Open
Number of Appendices:	Two: <ul style="list-style-type: none">• Capital Programme 2017/18 to 2020/21• Economic and Interest Rate Forecast
Background Papers:	N/A
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1.0 INTRODUCTION

- 1.1 In February 2018 Cabinet endorsed an ambitious three-year (2018/19 - 2020/21) capital programme amounting to some £800m. This report sets out the likely medium to long term borrowing requirement for the Council partly arising from that decision and reaffirms the Council's approach to borrowing as set out in the Treasury Management Strategy whilst highlighting the potential risks and benefits of various options.
- 1.2 Up to this point the Council has adopted the strategy of funding capital investment from internal cash balances and delayed entering into borrowing commitments. However, as explained throughout the report, this approach, which has been highly cost effective for the last few years, is no longer sustainable as in the short to medium-term the Council will need raise in the order of £230m additional finance to continue with its capital investment plans. Given the scale of the programme this is likely to be the biggest single financial transaction the Council will have undertaken in a generation.
- 1.3 Not only is this decision important because of the sums involved but also the part the capital programme plays in delivering the Council's strategic objectives and its role as a lever in contributing to the level of revenue savings required over the next few years.

- 1.4 Analysis indicates that the Council has a borrowing requirement of £230m over the next 3 years, (2019/20 £62.4m and 2020/21 £166.6m).
- 1.5 The scenarios discussed in this paper are to a large extent based on the Council's views on interest rates supplemented with leading market forecasts provided by the Council's treasury advisors.

1.6 To be updated to reflect the comments of the July 2018 Audit and Standards Advisory Committee

2.0 RECOMMENDATIONS

That Cabinet:

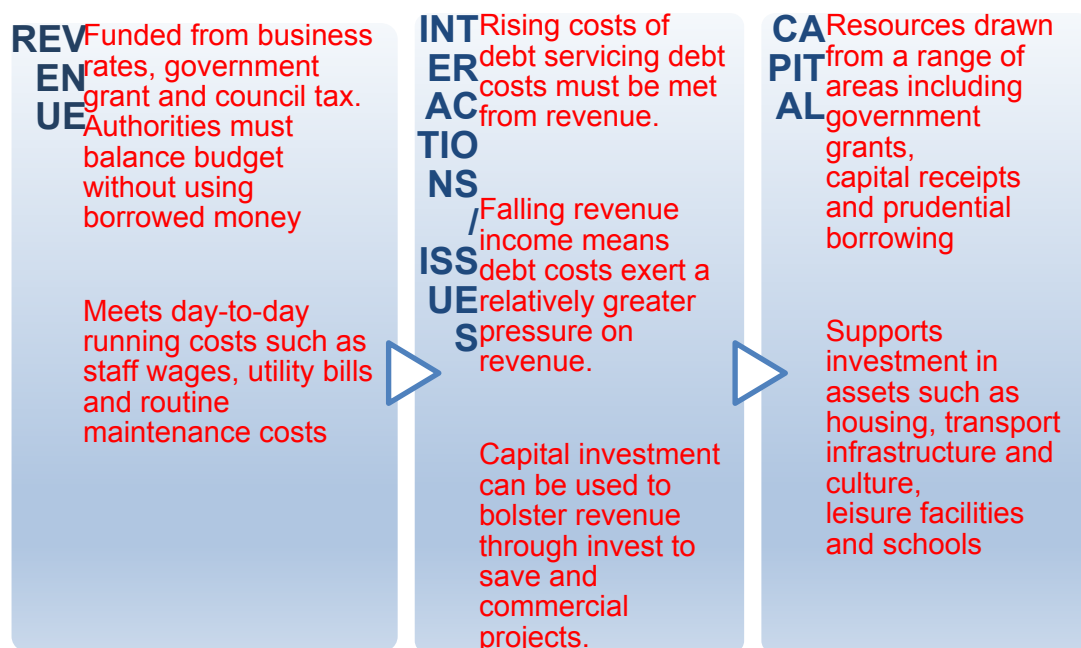
- 2.1 Note the Council's balance sheet analysis and estimated borrowing need as set out in section 5.
- 2.2 Approve the borrowing strategy as set out in this paper including the commencement of negotiations to agree a forward funding loan of up to £40m. See section 6.
- 2.3 Note that the actions recommended above are within the operational boundaries already agreed by Cabinet when setting the Treasury Management Strategy for 2018/19 as part of the budget setting process.
- 2.4 Note that a copy of this report was presented to the Audit and Standards Advisory Committee in July for review and consideration. The comments the Audit and Standards Advisory Committee are shown in paragraph 1.6.

3.0 BACKGROUND

- 3.1 The Council meets the costs of its statutory and discretionary services through a combination of revenue and capital expenditure. Revenue spending covers day-to-day costs such as payroll costs, heating and light. Capital expenditure relates to investments in assets such as buildings and roads. In 2017-18 the Council spent £181m on capital investments (2016-17 £102m).
- 3.2 A key difference between capital and revenue is that authorities can use long-term borrowing to support capital spending but not revenue spending. This gives Councils the freedom to invest in their asset bases and to pursue 'invest to save' schemes which can deliver revenue savings. However, Councils must ensure that borrowing is affordable and must meet debt servicing costs from revenue. These processes are largely self-regulated within the framework of the prudential code for capital finance. (see section 9)

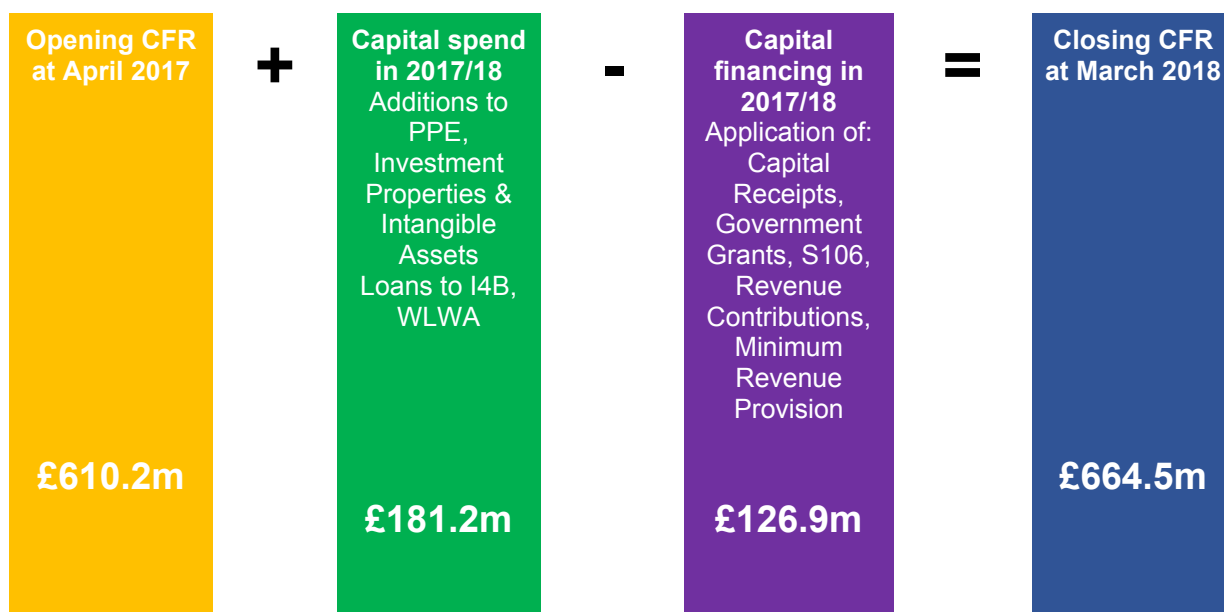
- 3.3 The linkages between capital and revenue expenditure are shown in figure 1 below.

Figure 1 - Capital & Revenue Expenditure Interaction



- 3.4 The prudential system for capital finance prescribes that any capital expenditure incurred must at the same time be financed by grants, revenue contributions, capital receipts, reserves or borrowing. Any capital expenditure not immediately financed by any of these sources gives rise to an increase in the Council's underlying need to borrow, otherwise known as the CFR (Capital Financing Requirement).

Figure 2 – Brent Council Capital Financing Requirement



- 3.5 At March 2018 the Council's balance sheet position included long-term borrowing of £410.6m and short-term investments amounting to £140.4m. At the same date the CFR (Capital Financing Requirement) or underlying need to borrow was £661.6m.

Treasury Management Strategy and its linkages with revenue savings

- 3.6 The difference between the Capital Financing Requirement and the current long term borrowing of the Council (£664.5m - £410.6m) is £253.9m. This reflects the effective strategy that has been pursued in recent years which has saved millions in capital financing interest and reduced the risk associated with holding large cash balances.
- 3.7 As the Capital Financing Requirement has not been fully funded with loan debt but by using cash reserves, balances and cash flow, this has used up £254m in cash that could have otherwise generated 0.45% (£1.1m) of investment interest income.
- 3.8 The Council could of course instead have chosen to borrow £254m up to its Capital Financing Requirement, however if this sum was borrowed for a duration of 25 years it would have cost approximately 2.45% or £6.2m a year from the PWLB (Public Works Loans Board). *In simple terms this means that the Council forgoes £1.1m in interest income whilst at the same time saving £6.2m in interest payable on borrowing. Capital financing costs of £5.1m per year have therefore successfully been avoided for several years.*
- 3.9 In the current economic environment where inflation has been relatively stable, the rate of interest on traditional investments is significantly lower than that on borrowing and where there are associated counterparty risks, this has been a prudent approach whilst also providing value for money for the Council.
- 3.10 A key element of the Council's successful financial strategy has been to expand the capital investment programme and enable it to deliver substantial revenue savings (e.g. the NAIL and PRS acquisition programmes are forecast to save £3.9m over the next 2 years).
- 3.11 Looking further ahead there are plans to utilise CIL (Community Infrastructure Levy) receipts which are now reaching the level required to undertake major infrastructure projects and in Feb 2018 Cabinet recommended that, subject to the business case and proper due diligence, a further £151m be made available to fund the acquisition of 300 additional private rented sector properties and 100 intermediate rent sector properties by I4B Holdings on top of the £100m already committed in phase 1 and largely delivered during 2017-18.
- 3.12 To date this major capital investment has been managed without the need to enter into new borrowing commitments, thereby reducing external interest costs as described above. However, it is self-evident that this could not be continued indefinitely, and this report demonstrates that the Council now needs to raise additional finance to continue its capital investment programme.
- 3.13 There is nothing unusual in this. Councils across the country have been utilising cash balances to finance capital investment and many are now having to borrow

as balances run down. Councils borrowed a total of £464m from the Public Works Loan Board during February 18 alone, according to figures released by the Debt Management Office, up on the January 18 total of £315m. The biggest sum was borrowed by Wolverhampton City Council, which took £50m in three loans with durations of 16, 22 and 33 years.

- 3.14 In fact, all that is unusual is that Brent's effective treasury strategy has succeeded in deferring the additional costs for so long. This report therefore sets out the likely timing and quantum of the medium to long term borrowing requirement for the Council whilst exploring several borrowing options and their associated risks/benefits.

4.0 APPROACH TO DETERMINING BORROWING NEED

- 4.1 In identifying the Council's future borrowing needs account was taken of the key financial assumptions underpinning the revenue and capital budget alongside a consideration of the authority's medium to long term financial strategies. Some of the key themes included:

- estimates of the level and timing of capital receipts
- treatment of demand led pressures
- planned efficiency savings
- major developments, partnerships i.e. I4B, NAIL & JV schemes
- borrowing levels and outstanding long term debt
- balance sheet health and reserves levels
- funding options (section 4.6)
- historic trends i.e. levels of programme slippage
- capital plans (3 year capital programme, including pipeline schemes)
- ongoing revenue liabilities created, and the implications for future capital plans and budgets
- other economic and market factors that might influence the manner and timing of the decision to borrow
- the pros and cons of alternative forms of funding, interest rate structures and repayment profiles
- the positive and negative impacts of borrowing in advance of need on the Council's cash balances

Maturity profile of existing debt

- 4.2 As shown in Figure 3 below, several Council loans are due to mature within the next few years (£26m within 5 years) that the Council will need to refinance. Given that interest rates are expected to increase in the near future, it may be prudent therefore to borrow in advance of their maturity dates whilst interest rates are still relatively low.

Figure 3 Maturity Profile of Existing Debt

Years	< 1	1 - 2	2 - 5	5 - 10	10 - 20	20 - 30	30 - 40	40 - 50	50 +	Total
£m	4.3	10.4	11.2	4.0	24.6	51.9	212.6	6.1	5.0	330.1

- 4.3 The profile above excludes £80m of Council's market loans (also referred to as LOBOs) which could be uplifted or recalled when they are next reviewed. However, considering interest rates are expected to stay relatively low (in comparison to the current average LOBO rate of 4.87%), this is unlikely to be the case in the near future. There may be an opportunity to repay the LOBO loans in the future, which will depend on the penalties imposed by the current funders in order to break the loan conditions. Officers will continue to assess any opportunities as they arise.

Counterparty risk

- 4.4 Between 2010-11 and 2016-17, the amount of cash held by the Council has increased three-fold, by approximately £109m. This has allowed the Council to borrow internally and lend to other authorities. However, a large amount of cash remains invested in other ways. Consequently, more of our cash is exposed to counterparty risk – the possibility that an institution holding an investment fails.
- 4.5 It is also worth noting that with recent high profile financial failures (at Councils such as Northamptonshire) the assumption that Councils are unlikely ever to default should be revisited. Following the recent s114 notice issued by Northamptonshire they have been removed from the Council's lending list.

Types of borrowing

- 4.6 As part of this assessment the Council has also reviewed a number of different types of funding, these include the following:

- **Bank Debt**

There are a myriad of private banks/institutions willing to lend to Councils in part attracted by strong financial covenants. The extent to which Council's borrow from private banks varies considerably from Council to Council. However, at Brent bank debt comprises less than a quarter the overall long term loan portfolio.

Pros

- Flexible, including potential to forward start
- Potential economic advantage over PWLB

Cons

- Likely to be a shorter duration
- Documentation may be more complex

▪ **PWLB**

The Public Works Loan Board (PWLB) is one of the principal sources of borrowing for Councils. It is a statutory body that issues loans to local authorities, and other specified bodies, from the National Loans Fund. Since 2004, Councils have been able to borrow (mainly for capital projects) without government consent, provided they can afford the borrowing costs.

Pros

- Certainty on liquidity
- Simple process and documentation (takes 48 hours from start to finish)
- Same rates for all

Cons

- Might be more expensive on an all-in basis

▪ **Local Authorities**

The market for lending between authorities has risen steadily in recent years, although this relates mostly to short-term loans, which are not generally suitable for the long-term finance that Brent now requires. At the end of 2016-17 outstanding debt between Councils stood at £6.53bn. Outstanding debt as of Q3 2017-18 had reached £8.48bn.

Pros

- Potentially lower rates
- Lower risk of default (to be reviewed in the context of recent failures)

Cons

- Usually a shorter duration
- May require the use of broker to locate authorities

▪ **Municipal Bond Agency**

Following four years of debate and preparation, in 2016 the new UK Municipal Bonds Agency was established. It is owned by 56 shareholding local authorities with the aim of facilitating the issuing of bonds by smaller local authorities, and to obtain a competitive price for their bonds within the conventional bond market.

As the Council did not foresee an immediate need to borrow at the time, and as it was aware of the risks of joint and several liability, it did not take any part in setting up the Local Government Bond Agency (LGBA). The arrangement requires that all 56 members collectively and individually guarantee the debt of each and every borrower jointly and severally

Pros

- Cheaper borrowing
- Can be used to raise substantial capital sums

Cons

- Joint & Several liability
(had the MBA been established a couple of years ago and had Brent and Northamptonshire been in it then Brent, and other Councils would have their default risk.

▪ **Pension Funds**

In 2017 Manchester City Council partnered with the Greater Manchester Pension Fund (GMPF) to build family homes for market rent and sale. The Council provided the land and GMPF put up the money. This was one of the first times a Council pension scheme had used its financial muscle to support a key Council aim: building homes. Since then other Council pension funds have followed Manchester's lead.

Pros

- Generally over longer term
- Can be used to raise substantial capital sums

Cons

- A preference towards investment in Housing
- Brent's Pension Fund requires an average return of 3.8% real (i.e. before inflation and taking on development risk would not be consistent with its risk appetite. This is therefore unlikely to be the cheapest option from the Council's point of view.

▪ **Cash Balances**

As noted in section 1 the Council has in recent years internally borrowed. This is a treasury management practice whereby an authority delays the need to borrow externally by temporarily using cash it holds for other purposes, such as earmarked reserves. This allows the authority to avoid paying interest costs until the original expenditure planned for the 'borrowed' cash falls due.

Pros

- Certainty
- Simple process
- Cost (when deposit interest foregone is less than current cost of borrowing)

Cons

- Defers the borrowing decision to time when cost of borrowing is higher

5 BALANCE SHEET AND TREASURY POSITION

- 5.1 The underlying need to borrow for capital purposes is reflected by the Capital Financing Requirement (CFR) which measures the cumulative capital expenditure that has not yet been financed from Council resources. Estimates of the CFR, based on the projected Revenue Budget and Capital programme over the next three years are shown in table 1.
- 5.2 The Council's closing CFR is calculated at £664.5m for 2017/18, outstanding loans total £410.6m at the end of the financial year, resulting in a gross borrowing requirement of £253.9m. **By deducting the gross borrowing requirement from available cash reserves you are therefore able to derive an investable balance or a (borrowing need).**

e.g. scenario 1 17/18 - £444.7m - £254m = £190.7m investable balance

TABLE 1 £M	2017-18	2018-19	2019-20	2020-21
General Fund CFR	515.1	536.1	631.8	748.0
HRA CFR	149.5	172.7	188.3	188.3
Total CFR	664.6	708.8	820.1	936.3
Existing Borrowing	410.6	410.6	404.5	401.4
Gross External Borrowing required to meet CFR	254.0	298.2	415.6	534.8
Projected Usable Reserves	303.4	179.9	172.3	165.2
Projected Working Capital	141.3	102.5	73.3	51.4
Available cash reserves	444.7	282.4	245.7	216.5
Investments / (New borrowing required)				
Scenario 1 - no slippage	190.7	(15.8)	(169.9)	(318.3)
Scenario 2 - 10% slippage	206.4	12.0	(131.3)	(257.8)
Scenario 3 - 25% slippage (most likely)	229.9	61.6	(62.4)	(166.6)
Scenario 4 - 35% slippage	245.5	98.2	(13.3)	(91.6)
Scenario 5 - 40% slippage	253.4	117.9	14.8	(50.6)

Notes:

- HRA borrowing includes £127.9m allocated to the HRA following the introduction of the self-financing regime introduced in March 2012. Increased to £149.5m by 17/18 due to £21.5m additional borrowing.

2. *The existing profile of borrowing **does not** include potential LOBO loan maturities which may or may not occur, over the next five years, individual loans totalling £80m, will be in a state of call.*
3. *Working capital is calculated by aggregating current assets and current liabilities.*
4. *Projected reserves includes General Fund, HRA and school balances, earmarked reserves, capital receipts reserve, capital grants unapplied, collection fund adjustment account, major repairs reserves, CIL and S106.*
5. *Annual inflation of 1.8% has been used to predict usable reserve and working capital balances*
6. *Capital estimates of spending include c£400m pipeline schemes*
7. *Per scenario 3 there is a borrowing requirement of £230m (19/20 £62.4m and 20/21 £166.6m)*

- 5.3 The increasing General Fund CFR is due to the Council's programme of capital investment, particularly in relation to NAIL, PRS schemes and the loan to I4B. (Appendix 1)
- 5.4 In reality this is not an exact science and there are many factors (and different combinations of factors) that will determine the precise amount and timing of any borrowing requirement. However the Council's projected capital programme over the next three years, alongside the projected financing, is fundamental in determining any borrowing strategy and has been used to arrive at 3 potential scenarios based on differing levels of capital programme slippage.
- 5.5 The capital outturn for 2016/17 was £101m versus a budget of £223m representing an underspend position for the year of 55%. Since then the capital team are better resourced and the governance procedures have been tightened along with greater oversight of forecasts. This has resulted in an under-spend of only 13.5% for 17/18 (£181m spend against a total budget of £209m) and this positive trend is expected to continue.
- 5.6 Based on previous experiences **scenario 3 is deemed to be the most likely outcome**. This indicates that the Council expects to require additional borrowing of c£62.4m in 2019/20 and c£166.6m in 2020/21 to meet the costs of the capital investments and maturing debt. However it is also worth noting that the programme also includes c£400m of pipeline schemes that are yet to be developed into firm projects. If there are delays in bringing forward pipeline schemes this will likely delay or at least reduce borrowing further.
- 5.7 Under the Prudential Code for Local Authorities, the Council's total debt should be lower than its highest forecast CFR over the next three years. Table 1 shows that the Council expects to comply with this requirement.

6.0 FUTURE BORROWING STRATEGY/OPTIONS

- 6.1 The Council's general policy objective is to ensure its level of debt is prudent and sustainable (i.e. keeping financing costs to a minimum) whilst addressing the key associated treasury risks. Projected capital expenditure levels, market conditions and interest rate levels are monitored throughout the year. This enables the Council to adapt borrowing strategies to minimise borrowing costs over the medium to longer term whilst maintaining financial stability.
- 6.2 Table 1 above demonstrates that the Council will need to seriously consider borrowing at some point in 2019/20. In recent years the Council's strategy has been to maintain borrowing at the lowest level possible unless interest rate prospects present a clear case for taking long term borrowing ahead of immediate requirements. However current interest rate forecasts along with the

significant levels of planned capital investment over the next three years means that this approach is no longer sustainable or optimal.

- 6.3 The Council will continue to adopt a flexible approach to borrowing in consultation with Arlingclose Ltd and as specified in the 18/19 Treasury Management Strategy will consider the following issues prior to undertaking any external borrowing: -
- ensure that the ongoing revenue liabilities created and the implications for future capital plans and budgets have been considered
 - evaluate economic and market factors that might influence the manner and timing of the decision to borrow
 - the pros and cons of alternative forms of funding, interest rate structures and repayment profiles
 - the positive and negative impacts of borrowing in advance of need on the Council's cash balances, in particular the increased exposure to credit risk that will arise as a result of investing this additional cash
 - the requirement in the context of the maturity profile of existing debt
- 6.4 Operationally the Council, through its Treasury Management function, manages the aggregate cash flow requirements of the Council. Within that cash flow requirement is the level of capital financing the Council needs to secure by way of borrowing. This is kept under daily review and officers raise additional loan finance, or make deposits in the market, either short or long term, as considered necessary.
- 6.5 Short term loans or deposits are raised or made depending on short term cash flows; generally with a maximum one year horizon but often much shorter. The loans raised or made in this way are to manage day to day cash flow.
- 6.6 Long term loans however are taken to reflect the Council's overall capital financing requirements. Broadly the long term loans and the aggregate need for capital financing are kept aligned. Occasionally however when market conditions (interest rates) are favourable advance loans can be raised in respect of known future liabilities.
- 6.7 In the current market with interest rates predicted to rise plus the scale of the Council's planned capital investment plans it might now be advantageous to lock in long term rates in advance of rates rising at a later date.
- 6.8 When viewed alongside the Council's soon to mature Council borrowing (Figure 3) this approach also offers an opportunity to minimise refinancing costs and alleviate interest rate risk. In broad terms, alongside the considerations listed in section 4.1 it is recommended that the Council adopt the following approach to borrowing: -

TABLE 2

Flat yield curve - rates to rise Seek to lock in medium/long term borrowing	Flat yield curve - rates to fall Consider holding off fixed borrowing
Inverse yield curve Preferential to lock out fixed	Positive yield curve Preferential to hold short

- A. If there are indications of **sharp fall** in long and short term rates (e.g. due to an increase in risk of a recession or deflation) then long term borrowing would be postponed.
- B. If there are indications of **sharp rise** in long and short term rates, perhaps arising from greater than expected economic activity, then the portfolio position will be appraised with the likely action that fixed rate funding will be drawn whilst interest rates are still cheap, including the consideration of forward funding, i.e. fixing rates now but drawing down funding in the future when required.

- 6.9 This framework of Treasury Management will enable the Council to manage its external borrowing in the most advantageous way and to take advantage of market conditions (interest rates) whenever possible to keep the aggregate cost of borrowing as low as possible whilst optimising the return available from any surplus funds (through making deposits).

Forward Starting Loans – recommended option

- 6.10 Given the current and expected economic position (Scenario B paragraph 6.8) officers are recommending the commencement of negotiations to enter into a forward starting loan agreement. Forward starting loans are agreed in advance of need, at a fixed rate for delivery on a pre-determined future date. A number of institutions currently offer these loans to Councils including commercial investors as well as the European Investment Bank (EIB).
- 6.11 A major advantage of forward loans is that by agreeing to a fixed rate now for future delivery (up to 5 years) the Council is able to hedge future interest rate exposure whilst avoiding a short term increase in costs, **as interest payments do not commence until the loan starts.**
- 6.12 It can therefore be used to reduce risk on the financing of planned capital expenditure and provide budget certainty. Compared to borrowing in advance there is a significant credit risk benefit as forward starting loans avoid excessive investment balances.
- 6.13 The Council has the option of directly engaging with institutions, procuring technical advice as and when required or delegating authority to a third party to conduct a competitive funding selection service on behalf of the Council including

the preparation of request for proposals, vetting, credit rating, setting specifications, negotiating contract terms etc.

- 6.14 The preferred approach is to directly engage with potential lenders and buy in the necessary expertise as and when required. This approach would achieve best value for money but would come at a cost, typically a % fee applied against the principal sum borrowed. A competitive funding selection service would fall outside of the services covered by the annual treasury management contract with Arlingclose.
- 6.15 Not only is this approach the most cost effective, it also builds up the internal capacity of the Council which will allow the treasury function to undertake similar deals in the future should opportunities arise. As this report has shown, future and larger transactions will be required, and so building internal capacity and expertise makes sense. These future transactions will most probably be placed via a range of institutions to spread risk, for example some or all of PWLB, market loans, Municipal Bonds Agency and others, according to the prevailing interest rate and other conditions. By building expertise now the Council will be better placed to secure the best value from the future, and larger, borrowing transactions anticipated in 2020/21.
- 6.16 It is therefore recommended that officers directly engage with potential lenders and bring in technical advice as and when required in order to borrow an initial sum of up to £40m on a forward funding basis.
- 6.17 As the authority to borrow in this way has already been agreed by Cabinet when setting the 18/19 Treasury Management Strategy should any opportunities arise in the future for similar deals they will be reported as normal to the Audit & Advisory Committee via the treasury mid-year and outturn updates.

Other borrowing options

Borrow longer term debt now

- 6.18 The default source of borrowing for local authorities is the Public Works Loans Board - a statutory body operating within the UK Debt Management Office (an Executive Agency of HM Treasury). The Council could look to fix out some longer-term debt with the PWLB in 2018/19 whilst interest rates are still relatively low. This could be used to address the Council's under-borrowed position. This would be more expensive than forward borrowing as the Council would incur interest costs in the interim period before the borrowing is required, which is expected to be sometime during 2019/20. However one major advantage of PWLB funding is the simple process and ease of access to funding. Following a phone call the terms can be agreed at the time and the advance of funds made within 48 hours.
- 6.19 It is worth noting that a bill to restrict Councils borrowing from central government is to be considered by the House of Commons Local Authorities (Borrowing and Investment) Bill 2017-18 and will be debated by MPs at its second reading on 15 June. This follows concerns raised over Council's borrowing from the Public Works Loan Board (PWLB) to raise revenue for property acquisitions. Hence there is a risk (albeit a small one) that access could be constrained in the future.

Borrow on a short term rolling basis

- 6.20 The Council could fund on a rolling short term basis from other local authorities initially and arrange forward starting loans, to hedge against future interest rate rises over the longer term. This provides flexible, cheap funding over the near term, whilst providing longer term certainty further into the future. This approach is not recommended as the Council can use its cash balance in the short term as modelled in Table 1 and save money on interest costs whilst avoiding the risks associated with holding excessive cash balances.

Borrow to short term to cover the entire forward period

- 6.21 Another approach would be to borrow fixed rate funding from other local authorities to cover the entire forward period, eliminating short term interest rate risk, but again this would be at a higher cost and may not be necessary given the Council's current cash position.

Do nothing until 2019/20

- 6.22 The Council could do nothing for now and seek to borrow in 2019/20 when needed however there is a risk that the Council will have to refinance debt under unfavourable terms, either due to a lack of availability of replacement financing or an increase in interest rates. This approach is not recommended as it does not match the Council's borrowing need, which is to fix an amount and rate now by forward funding, without incurring the interest cost.

7.0 RISKS

- 7.1 With forward starting loans there is a risk that the Council might agree the loan and then not require the funds. This could prove costly if investment returns remain low. The Council should be certain of its borrowing requirements before entering into this type of arrangement.
- 7.2 Table 1 sets out a range of borrowing need scenarios based on differing levels of capital slippage. **The 3 year capital programme would have to slip by 45% in order for borrowing not to be required before 2020/21.**
- 7.3 It is also worth noting that as shown in Figure 3 the Council will have to refinance £26m worth of loans that will be maturing within 5 years. This drastically reduces the likelihood of not requiring the funds at the anticipated drawdown date.
- 7.4 Conversely, should it transpire that funds are required earlier than planned these forward loan arrangements provide the flexibility to execute the transaction earlier. There is also the option of utilising PWLB or local authority lending to cover this risk off.

8.0 FINANCIAL IMPLICATIONS

- 8.1 The Council will soon need to raise significant additional finance to continue with its capital investment plans. Given the scale of the programme this is likely to be the biggest single financial undertaking the Council would have undertaken in many years so this decision is of great significance.

- 8.2 Estimates indicate that the Council will have a borrowing requirement of £230m over the next 3 years, (2019/20 £62.4m and 2020/21 £166.6m).
- 8.3 Should the recommended option be agreed the Council will enter into a forward funding arrangement, agreeing to a fixed rate now for future delivery. Such an arrangement would likely attract an arrangement fee. The Council may also need to bring in additional support (legal and technical financial) in order to successfully execute such a transaction. These costs would be funded from the Councils existing treasury debt management budget.
- 8.4 Analysis of the costs associated with a forward funding loan versus a traditional PWLB loan based on predicted interest rates indicates that demonstrable savings could be secured.
- 8.5 When borrowing is undertaken in advance of need there is usually a net cost of holding this money until it is used (cost of carry). The cost of carry needs to be viewed in conjunction with forecast changes in interest rates; where a delay in borrowing could lead to the need to borrow at a future higher rate and where the increased interest over the loan period would far outweigh the short term cost to carry. One of the major benefits of the recommended forward funding option is the ability to fix a competitive rate in advance without incurring interest costs.

9.0 LEGAL POWERS RELIED ON AND ANY LEGAL IMPLICATIONS

- 9.1 In recognition of the importance of capital investment in asset and treasury management to Council activities, CIPFA and central government have compiled codes of practice and regulations for Councils to follow. These ensure that Councils have effective processes and practices in place to control, manage and govern capital investment decisions, that include borrowing and treasury management practices.
- 9.2 The Prudential Code was introduced in 2004 as a framework to support Councils and help them show effective control levels of decisions relating to capital investment activity, including borrowing. Before this, capital investment levels in Councils were government regulated.
- 9.3 This self-regulated approach has enabled the Council to adopt borrowing and treasury management strategies that fit with corporate plans and objectives. The framework allows the Council to judge for itself what is affordable and sustainable. The Prudential Code sits alongside CIPFA's treasury management code, which sets out the requirements for a professional treasury management function.
- 9.4 A key requirement of the code is for the Council to produce an annual treasury management strategy before the start of each financial year. The strategy includes prudential indicators that are set out within the Prudential Code. They form a set of 12 limits and ratios that all Councils must calculate and use to show Councilors and the public that capital plans are affordable and sustainable.
- 9.5 The recommendations set out in this report fall within the boundaries encapsulated in the Council's treasury management strategy for 2018/19.

Codes of Practice and Regulations

Local Government Act 2003

- 9.6 Under part 1 chapter 1 of the Local Government Act 2003, a local authority may borrow for any purpose relevant to its functions or for “the prudent management of its financial affairs”. Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 (SI 2003/3146), as amended.
- 9.7 Each authority must set a total borrowing limit for itself in accordance with the principles of the Prudential Code. The borrowing limit will be related to the revenue streams available to the local authority, with which it can repay the debt.
- 9.8 The total amount that a local authority may borrow is governed by the requirements of CIPFA’s Prudential Code for Capital Finance in Local Authorities; and by the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 (SI 2003/3146), as amended

The Prudential Code for Capital Finance in Local Authorities

- 9.9 A professional code of practice to help Councils govern capital investment decisions by providing a framework that includes Indicators to demonstrate affordability and sustainability.

Treasury management in the Public Services: Code of Practice and cross-sectoral guidance notes (CIPFA treasury management code)

- 9.10 Adopting this code is a requirement of the Prudential Code. It makes recommendations to provide a basis for Councils to create clear treasury management objectives and structure and maintain sound treasury management policies and practices

10.0 Equality Implications

- 10.1 None arising from this report.

Report sign off:

CONRAD HALL
Chief Finance Officer