AUDIT AND RISK MANAGEMENT PANEL	DATE 14 December 2021	ITEM NO 7
TITLE Review of the Capital Financing Requirement	**WARD (S)** All	
CHIEF OFFICER Director of Finance	**CABINET MEMBER** Finance and Resources	
DECISION CLASSIFICATION Non-Key	**IS THE FINAL DECISION ON THE RECOMMENDATIONS IN THIS REPORT TO BE MADE AT THIS MEETING?** Yes	

1. **Decision required**

This report makes the following recommendations to the decision-maker:

1.1 to note that the council's utilisation of internal borrowing to cashflow its capital investment programme has saved the council in excess of £40m in gross external interest payments since 2011

1.2 to note that had the council fully externalised its borrowing requirement, external debt payments would be more than £10m higher every year, than they are today

1.3 to note that internal borrowing is a time limited mechanism and that excessive use brings with it increased refinancing risk

1.4 to note the actions being undertaken to reduce refinancing risk within the council's Capital Financing Requirement and the revenue consequences of doing so:

Sections 5.20 – 5.25 (General Fund)
Sections 5.31 – 5.32 (HRA)
Section 10.7 (overall)
Section 12 (actions undertaken).

2. Links to the Royal Greenwich high level objectives

2.1 The Borrowing review will help towards contributing to the delivery of the Corporate Plan. This report therefore cuts across each of the high-level objectives as follows:

- A Healthier Greenwich
- A Safer Greenwich
- A Great Place to Grow Up
- Delivering Homes Through Economic Growth
- A Cleaner, Greener Greenwich
- Economic Prosperity for All
- A Great Place to Be
- A Strong Vibrant and Well-run Borough

3. Purpose of Report and Executive Summary

3.1 This report relates to long term borrowing supporting the council's capital investment programme. The report does not recommend undertaking external borrowing to directly support the provision of day to day services.

3.2 The purpose of this report is to highlight the options available to the Council, in securing borrowing to fund the capital programme and the use of internal and external borrowing to deliver Value for Money. A glossary is attached to further explain terms.

3.3 The Council started the current year with an underlying need to borrow of £673m but had only actually drawn down £375m of external loans and therefore carries £298m in internal borrowing to finance the rest of the Capital Financing Requirement (CFR).

3.4 By not fully externalising borrowing since 2011, the Council has saved over £40m in gross interest payments and furthermore, annual interest costs are more than £10m lower than they would have been.

3.5 Increasing internal borrowing gives rise to refinancing risk, which is heightened as prospects for future borrowing rate rises come into focus. This coupled with agreed future capital investment programmes which have an underlying need to borrow, leaves the council looking to draw down £424m of external loans in the coming years, for which budget capacity is provided, but in doing so, will reduce the council's ability to offset service overspends (through a reduction in overall treasury management savings).

4. Introduction and Background

Governance

4.1 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".

4.2 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.

4.3 The prudential code does not prescribe formulae allowing the exact calculation of prudential limit, relying instead on the judgement of the local authority chief finance officer and on "generally accepted accounting practices".

4.4 Within the Prudential Indicators approved by Council, there are a number of key indicators to ensure that the Authority operates its activities within well-defined limits.

4.5 Approving capital schemes, including those which increase the Capital Financing Requirement, is subject to the Leaders Scheme of Delegation and the Council has delegated authority for the implementation of its borrowing strategy to the Section 151 Officer. A treasury management budget exists in both the General Fund and HRA to finance borrowing undertaken and the Treasury Management team, under the supervision of the Director of Finance, works closely with the Council advisors, Link Group, when undertaking external borrowing.

Capital Programme

4.6 The Council's capital programme plays an important role in the delivery of the Council's strategic objectives from building new affordable homes, regeneration, infrastructure, economic development and educational attainment through to leisure, health and social care provision, to mention but a few.

4.7 The overall programme is made up of many projects and these will be subject to and the relevant approval by the Leaders Scheme of Delegation and reported in the Treasury Management and Capital Strategy reports.

4.8 The prudential system for capital finance prescribes that any capital expenditure incurred must at the same time be financed – this is usually via capital receipts, capital grants or revenue contributions.

4.9 Any capital expenditure not financed by any of these sources, gives rise to an increase in the council's underlying need to borrow. This is known as the Capital Financing Requirement (CFR).

4.10 A theoretical example could be a capital investment project costing £20m for constructing a new care home. The forecast resources to fund the programme could be:

- £10m Usable Capital Receipts
- £6m Capital Grant
- £4m Contribution from Revenue

4.11 The CFR impact if all three sources of income are realised would be NIL – the project has been fully financed. However, there are risks around the financing sources, for example the capital receipt could be lower than anticipated or delayed or not realised altogether. Going further with the example, if the capital receipt was £1m lower than originally forecast, then this would mean that the CFR had increased by £1m and the council would still need to find the funds to pay the contractor for the works undertaken to build the new care home.

4.12 The council could take out a physical loan, at which point it would start to pay interest on that loan. Alternatively, it could utilise its cash balances to cashflow the payment to the contractor and not externally borrow until it needs to later. This is done by temporarily using reserves, balances and other resources that are deemed as not required in the short term. It is also often appropriate to internally borrow in circumstances where a capital receipt is anticipated but has not yet been received.

4.13 This method of internally borrowing from the balance sheet is only intended for the short term. At the point where the reserves and provisions need to be utilised for their originally intended purpose, the

Council will need to externally borrow to replace the internally borrowed position.

4.14 As at March 2021, the Council's underlying need to borrow, or CFR, was £673m. This represents the current net cumulative amount of capital investment not financed by other means (see 4.9), over the last century.

4.15 This approach of delaying external borrowing has saved the council over £40m in gross external interest payments (any investment returns with additional cash would have been minimal with the bank rate at or below 0.5% during that period) since 2011 and left annual interest costs more than £10m lower as of 2021. The savings generated from this approach have contributed towards helping to offset the effects of service departments that have overspent during this period. This approach and its effect in helping to offset overspends has consistently been flagged within the council's revenue monitoring reports as time limited and something which is not sustainable into the future.

4.16 The policy of avoiding new borrowing by temporarily using cash balances has served the Council well over the last few years. This strategy was prudent as it saved on external interest payable and any surplus cash would have attracted a very low investment return. Minimising counterparty risk (i.e. quality of who the council invests with) on placing investments also needed to be considered. With the exception of the specific loan for LED works (MEEF) undertaken in the first half of the financial year, the Council's last general long-term borrowing was made in June 2012.

4.17 There is nothing unusual in the council's approach. In a recent consultation (whose results are due to be published imminently) on the Prudential and Treasury Management Codes of Practice, CIPFA recommends councils to carry out a Liability Benchmarking exercise when undertaking borrowing.

4.18 The Liability Benchmark is effectively the Net Borrowing Requirement of the Council (CFR minus long term core cash from reserves and provisions etc), plus a liquidity allowance (working capital to collect monies and pay suppliers). This is essentially what the council has been undertaking for the last decade – using cash balances to depress external borrowing.

4.19 Councils across the country have been utilising their cash balances to cashflow capital investment. This approach has always been viewed as time limited and can only be applied whilst external economic conditions continue, borrowing rates remain low and importantly a sufficient cash balance level is there to support the internally borrowed position.

5. <u>Capital Financing Requirement</u>

5.1 The CFR measures the extent to which the capital expenditure has not yet been financed by either revenue or capital resources. Essentially it measures the Council's underlying borrowing need. Each year, the CFR will increase by the amount of new capital expenditure not immediately financed.

5.2 The CFR does not increase indefinitely though, as the council is required to set aside funds each year to provide for the future repayment of debt – this is known as the Minimum Revenue Provision (MRP).

5.3 MRP is a statutory annual revenue charge which broadly reduces the indebtedness in line with each asset's life and so charges the economic consumption of capital assets as they are used.

5.4 The Council is required to determine an amount of MRP for each year which it considers to be prudent. The broad aim of prudent provision is to require local authorities to put aside revenue over time to cover their CFR. In doing so, local authorities should align the period over which they charge MRP to one that is commensurate with the period over which their capital investment provides benefits.

5.5 The [General Fund] MRP [borrowing] charge in 2020/21 was ~£5m. There is no statutory requirement for MRP to be charged for the HRA's share of the underlying need to borrow. The Council's policy on MRP is agreed by full Council in February each year and can be found in the Capital strategy report.

5.6 The graph below shows the projection for the CFR over the next 60 years. There will be some degree of uncertainty as capital project forecasts can vary from year to year.

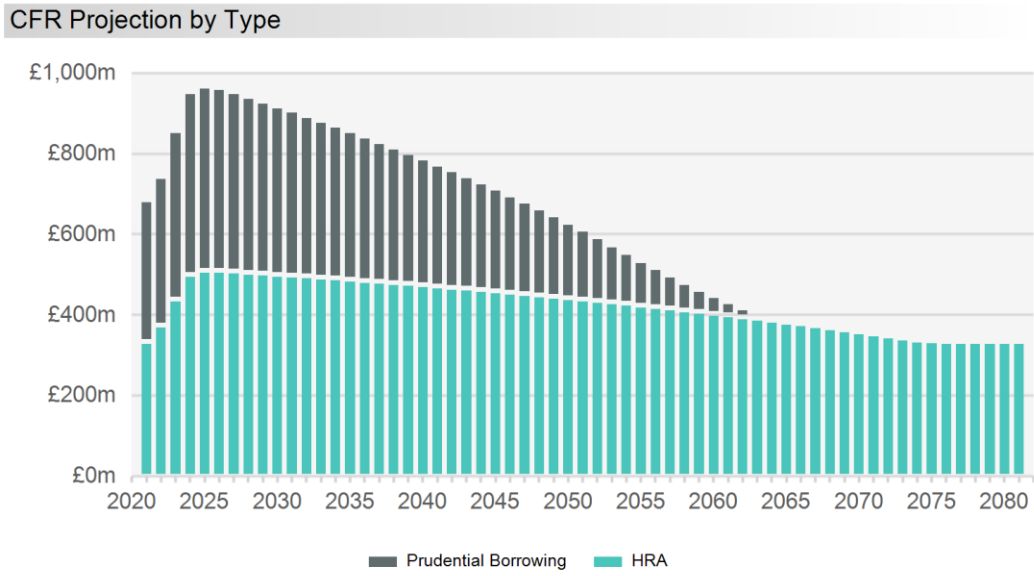

Chart 1: CFR projection over 60 years

5.7 Chart 1 demonstrates the total underlying need to borrow by the Council's approved Capital Programme. The overall CFR is projected to steadily increase over the next 5 years before reducing in 2025/26, as approved capital investment plans reach maturity and thereafter MRP charges reduce its value.

5.8 The CFR for the HRA is forecast to increase from £335m to £514m. This is driven by the Greenwich build programme, which is delivering new affordable housing for the HRA. Some of the programme is funded through capital grant but will still leave an underlying need to borrow of £179m so far.

5.9 The CFR for the GF is projected to increase from £338m to £489m, this is driven from capital programme through Priority Investment, Schools / Early Years and general fund housing development. Details of the capital programmes can be found in the Capital outturn report 2020/21.

5.10 The total current CFR is partly met through external borrowing with the difference being met by internal borrowing. The level at which the internal borrowing position can be maintained will mainly be contingent on working capital and reserves that are available to temporarily borrow from internally.

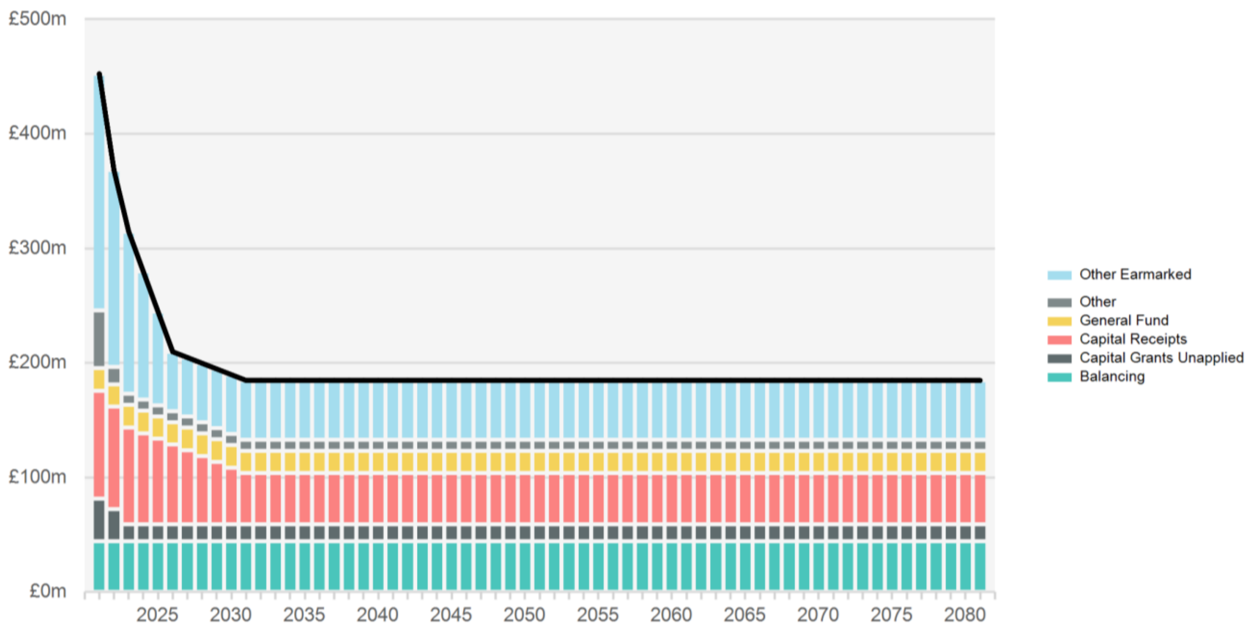

Chart 2: Forecast Reserves and Balances

5.11 Chart 2 shows a potential forecast of Reserves and Balances decreasing over the next 10 years, as services utilise those resources for their intended purpose. As with the CFR forecast, it is subject to a degree of uncertainty. In Chart 1, the CFR is projected to increase over the next few years, while the reserves and balances that support internal borrowing are projected to decrease over the same period.

5.12 Looking at the picture in 2022/23, the CFR is forecast to increase to £857m and leading to an under borrowing position of £476m (if no new external borrowing is undertaken). Whilst the reserves and balances that are available to support internal borrowing is £314m, this would mean that the council would no longer be able to support the under borrowing position and external borrowing would be required to support the capital finance requirement (and before consideration of working capital balance requirements). It is important to note that the liquidity risk will continue to increase the longer external borrowing is delayed.

5.13 If the reserves and balances were to be called upon quicker than expected, this would accelerate / accentuate the position described in 5.12.

Borrowing Plan

5.14 A Liability Benchmark can be created for the General Fund (Chart 3), HRA (Chart 4) and consolidating both areas (Chart 5)

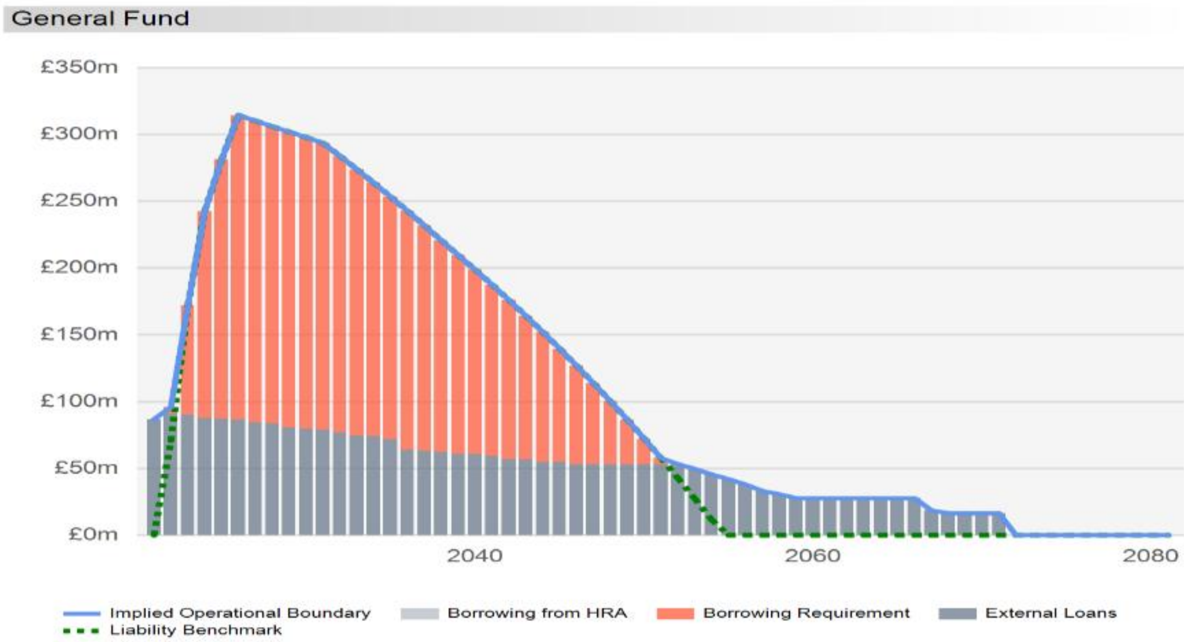

Chart 3: Liability Benchmark for General Fund

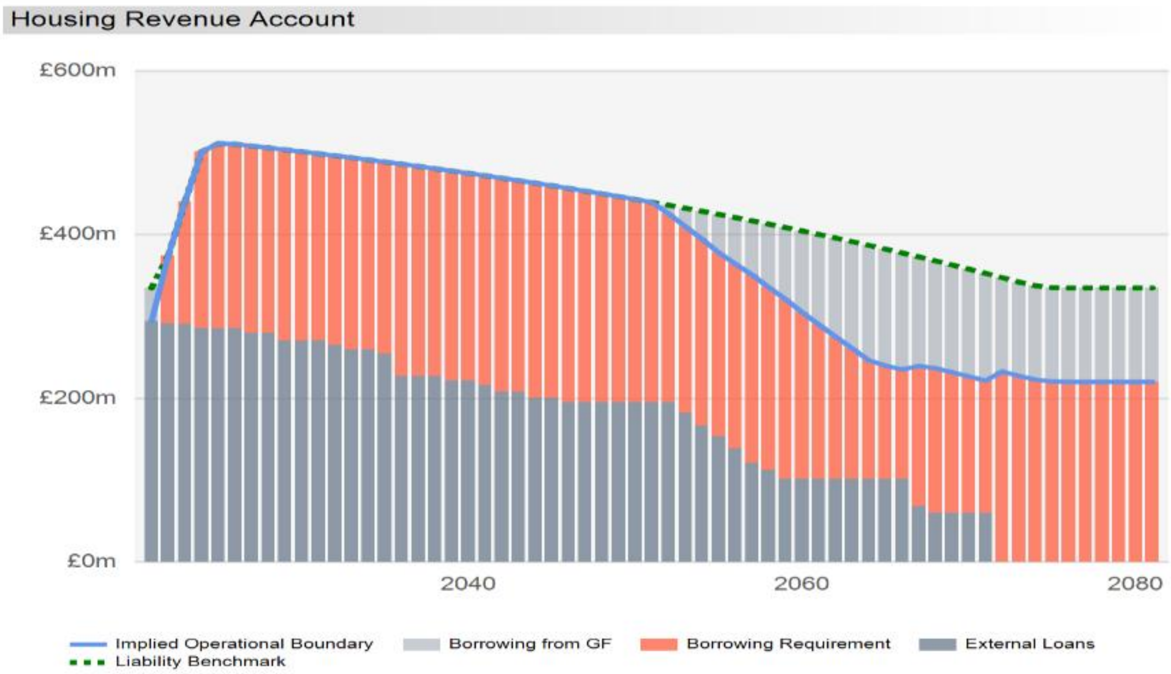

Chart 4: Liability Benchmark for HRA

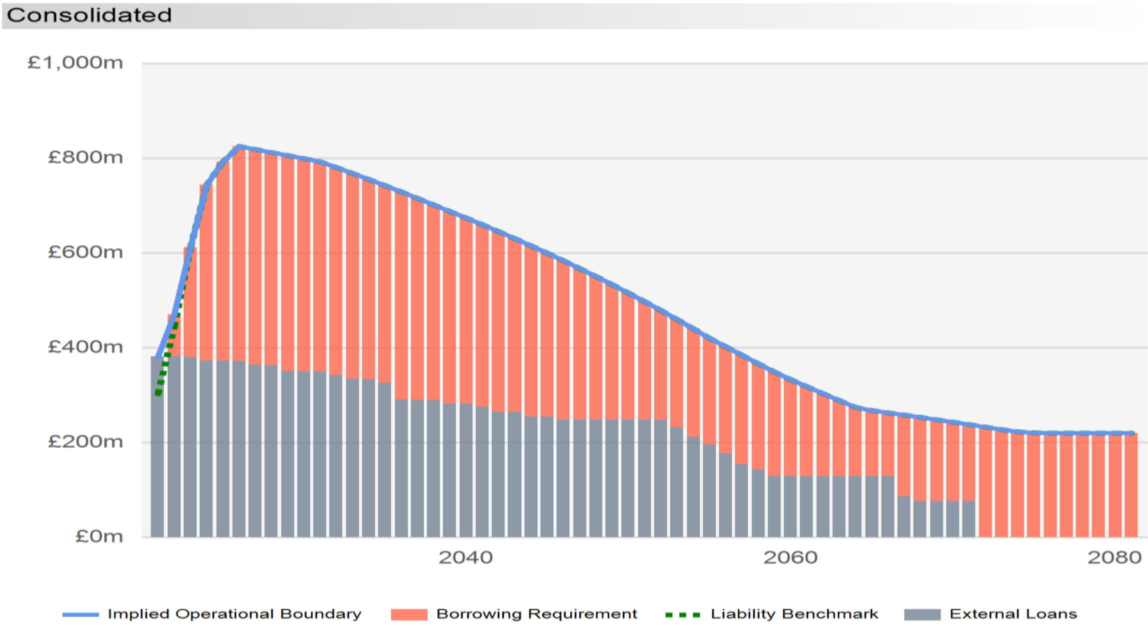

Chart 5: Liability benchmark Consolidated

5.15 The Liability Benchmark charts show the net borrowing requirement (Green line) for the next 60 years. Both the GF and HRA are showing an external borrowing requirement (salmon pink coloured bars) thus identifying where the Council is exposed to interest rate liquidity and refinancing risks.

5.16 Conversely where external loans exceed the Liability Benchmark line, this highlights a potentially overborrowed position which will result in excess cash requirement (this occurs within the GF graph from 2052 onwards).

5.17 The HRA is under borrowed from around 2052 and effectively may need to borrow from the GF, however the consolidated position in Chart 5 is within the liability benchmark.

5.18 These forecasts are decades into the future and much will likely have changed by then.

5.19 Table 1 looks at a shorter timeframe of 10 years and sets out the external borrowing requirement on the CFR projection.

Table 1 - Planned Borrowing

Ref	Reducing Risk - Externalising Borrowing	2021/22 (£'000)	2022/23 (£'000)	2023/24 (£'000)	2024/25 (£'000)	2025/26 (£'000)	2026/27 (£'000)	2027/28 (£'000)	2028/29 (£'000)	2029/30 (£'000)	2030/31 (£'000)	Total (£'000)
1	CFR for Borrowing	**743,243**	**856,667**	**953,511**	**967,126**	**964,459**	**953,099**	**941,491**	**930,249**	**918,760**	**907,016**	
2	Existing / Projected Borrowing	(382,455)	(380,465)	(372,946)	(372,338)	(371,729)	(364,211)	(363,603)	(350,902)	(350,294)	(342,775)	
3	Internal Borrowing	360,788	476,202	580,565	594,788	592,730	588,888	577,888	579,347	568,466	564,241	
4	Balances used for Internal Borrowing	368,202	314,702	279,702	244,702	209,702	204,702	199,702	194,702	189,702	184,702	
5	Cumulative New Borrowing (incl wcap)	(62,622)	(206,581)	(346,014)	(395,309)	(422,393)	(423,623)	(423,623)	(423,623)	(423,623)	(423,623)	
6	***Proposed Borrowing Externalisation***	***(62,622)***	***(143,959)***	***(139,433)***	***(49,295)***	***(27,084)***	***(1,230)***					***(423,623)***
7	*for GF*	*22,622*	*38,959*	*77,807*	*38,139*	*25,751*	*1,230*					*204,508*
8	*for HRA*	*40,000*	*105,000*	*61,626*	*11,156*	*1,333*						*219,115*
9	Total Borrowing after Externalisation	**(445,077)**	**(587,046)**	**(718,960)**	**(767,647)**	**(794,122)**	**(787,834)**	**(787,226)**	**(774,525)**	**(773,917)**	**(766,398)**	
10	Under Borrowing after Externalisation	**298,166**	**269,621**	**234,551**	**199,479**	**170,337**	**165,265**	**154,265**	**155,724**	**144,843**	**140,618**	
11	Under Borrowing as a % of CFR	**40%**	**31%**	**25%**	**21%**	**18%**	**17%**	**16%**	**17%**	**16%**	**16%**	

5.20 Table 1 forecasts that the Council could require £424m of external borrowing over the next ten years. The approach and timing of borrowing this amount will need to take various of factors into consideration before actual borrowing is undertaken.

5.21 Of the £424m total, £219m of borrowing will be for the HRA, largely to support the "Greenwich Builds" programme, while £205m will be needed for the GF capital programmes such as priority investment and housing development schemes. Ordinarily, the council could have commenced drawing down the first two years and reviewing, however, given the magnitude, the position will be kept under more frequent review and closely aligned to developments in the council's overall capital programme.

5.22 After external borrowing has been undertaken, the Council will still retain a level of internal borrowing. However, this will have reduced from 44% (opening position this year) to 21% by 2024/25 reflecting the lower level of refinancing risk.

<u>General Fund impact</u>

5.23 The impact of the GF externally borrowing £205m as set out in Table 1, taking a prudent assumption that borrowing can be drawn at 2.5%, would be for an additional £0.6m of interest payments in the first year, rising to a cumulative £5.1m per year by 2030/31.

5.24 The GF will also be impacted from the £40m borrowing that the HRA will externalise (see Housing Revenue impact), as this is currently borrowed from the GF.

5.25 Total forecast reductions in General Fund treasury management capacity (currently used to partially offset service overspends) are forecast to be £2.5m in 2022/23, rising thereafter.

Housing Revenue Account impact

5.26 The Local Government Finance and Housing Act 1989 requires Councils who own and provide social rent housing, to separate all the financial activities relating to the Council acting as landlord into a ring-fenced account known as the Housing Revenue Account (HRA).

5.27 Since HRA Self Financing commenced in 2012, the Council has adopted the two loans pool approach for long term debt, with existing long-term debt at the time split between the HRA and General Fund, with all long-term loans raised after allocated into either the HRA or GF pool.

5.28 The HRA commenced Self Financing in 2012 with £334m of external debt, but as loans have matured (and not been replaced) over the intervening period, the current position for the HRA is £294m of external borrowing and £40m of internal borrowing. As PWLB and other borrowing rates are at or near to historical low levels, this will be a good opportunity to externalise the £40m of internal borrowing and lock in the low rates.

5.29 The externalising of the £40m will see the HRA bear external debt interest, but potentially at a new, lower rate than it has been paying previously by borrowing from the GF.

5.30 The HRA CFR is expected to increase over the next 10 years to meet the financing requirements of the 'Greenwich Build' project. The CFR will increase from £335m to £514m, which will increase the underlying need to borrow by £179m. At this level the underlying borrowing will need to be met externally, as current reserves and balances would not be able to support increased levels of internal borrowing over the long term.

5.31 The gross impact of the HRA externally borrowing £219m as set out in Table 1, taking a prudent assumption that borrowing can be drawn at 2.5%, would be for an additional £1m of interest payments in the first year, rising to a cumulative £5.5m per year by 2030/31. With the externalisation meaning that the HRA no longer borrows from the GF, the overall net effect in year one would in fact be a saving (para 5.29) of around £0.8m.

5.32 The HRA Business Plan contains a budget for treasury management, with debt costs met largely through rental income.

6. Approach to Borrowing

6.1 Borrowing decisions have long-term financial consequences and it is important that treasury strategies consider the long and short-term risks of borrowing decisions.

6.2 In undertaking this level of borrowing, the Council needs to take account 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:

- capital financing requirement and timing of borrowing needs
- borrowing levels and loan mature profile
- type of borrowing that is available for the Council to access
- other economic and market factors that might influence the manner and timing of the decision to borrow
- balance sheet health and reserves levels

6.3 The Authority has various borrowing options which could be considered if there is a need to borrow externally. The main borrowing options available are detailed below.

Public Works Loan Board (PWLB)

6.4 The capacity to borrow from the PWLB is constrained by the approved CFR projections and the Borrowing in Advance of Need policy. Borrowing from the PWLB will mean that the Authority could either be exposed to a cost of carry, or increased interest rate risk depending on when borrowing is undertaken. The PWLB currently offers terms for the refinancing of its loans.

6.5 After consultation in 2020, the margin applied to local authority General Fund PWLB Certainty Rate borrowing returned to 80bps (from 180bps) above the Gilt. However, the Government can vary the margin thereby making PWLB an expensive option.

6.6 Another requirement after 2020, was a statement from the S151 Officer to confirm that the Authority has no intention to buy investment assets primarily for yield (i.e. commercial activity) at any point in the next three years. The Authority will be required to submit high-level capital and financing plans before borrowing is approved.

Market Loans (including Private Placements)

6.7 Market loans in the form of private placements can be arranged from institutional lenders, such as a bank. These loans are normally arranged through a private placement where a lender will provide the funding required based on their requirements and agreed with the borrower.

Forward starting loans

6.8 Forward Starting Loans enable councils to fix interest rates and the finance for projects, years before development begins thereby reducing interest rate risk, cost of carry and adding certainty to project returns. Borrowers pay a premium over the PWLB's certainty rate, but they are guaranteed a fixed interest rate with a pre-determined drawdown rate and can agree a sum to be borrowed on a pre-determined future date.

6.9 Forward-starting loans have seen an increased uptake in the last year and provide certainty to local authorities on the cost of future capital spending. Forward-starting loans have been issued in the past by the European Investment Bank. Loans are not generally offered with an automatic right to refinance.

6.10 Access to market loans would typically be restricted to borrowers seeking larger sums – in excess of £20m up to £200m. Larger amounts may need to be split amongst several investors depending on the amounts.

6.11 There is more work involved in arranging a loan from market lenders and this will involve lenders doing their due diligence on the Authority which will include assessing financial and credit positions and reviewing the medium-term financial plan.

Public Bond issue

6.12 Public bond markets are available to raise large amounts of finance and can provide competitive pricing for money required upfront compared to private placements. Typically, borrowing in the range of £250m and above use Bonds.

6.13 The Council also can raise Bonds through the Municipal Bond Agency (MBA) which can issue a public bond. The MBA was established as a local authority owned competitor to the Public Works Loan Board (PWLB) to drive down the cost of local authority borrowing through private sector intervention. The aim is to minimise the interest costs to a level below that of Central Government issued UK Gilts, or the “spread” to gilts.

Green Loans & Environmental, Social and Governance (ESG) Bonds

6.14 With the Council pledged to be “carbon net zero” by 2030, financing these investments requires the Council to remain cognisant of all possible financing avenues to maximise the amount of resource they can afford. One such way to do this is to launch a public green bond. Fundamental to this though is an understanding of which carbon-based costs should fall to the council and in fact what should the government be funding, before any consideration of local bond schemes.

6.15 Bonds in general will involve more time in terms of resources, input from various advisors and officers. In addition, there would be a need for a credit rating to be obtained from a credit rating agency and maintained for the life of the bond issue along with legal advice from specialist external legal advisors and the associated costs. Fees associated for bond issues can be higher compared to other forms of financing due to the various parties involved to get the bond to market.

6.16 The preferred source of borrowing will depend on several factors, mostly the rate of borrowing, option for flexible drawdown and requirement for ESG products.

The Mayor of London’s Energy Efficiency Fund (MEEF)

6.17 MEEF is a new investment fund, established by the GLA with funding from the European Commission, which is aimed at helping London to achieve its ambition of being a zero-carbon city.

6.18 MEEF has access to £500m of financing which Local Authorities are able to access for funding up to 100% of the capital cost of a project which has low carbon credentials.

6.19 MEEF can provide flexible loans at below equivalent PWLB rates for 19 years locking into a fixed interest rate, while allowing drawdowns over the period to 31 May 2023.

6.20 MEEF loans provide an alternative to PWLB as a source to funding projects which are linked to the Council`s carbon neutral plan, like installing electric vehicle charging points.

7. Level of Borrowing

7.1 The Council's outstanding debt portfolio is currently £386m as at 30 September 2021. This is mainly made up of PWLB and LOBO loans from the banks, with borrowing undertaken at fixed rates.

7.2 The Council's outstanding debt portfolio is used to fund historical capital investment for the HRA and general fund. Table 2 shows the breakdown

Table 2 - External Borrowing as at 30/09/21

External Loans (£m)	HRA	GF	Weighted average
PWLB	192.9	52.7	4.54%
Market Loans	101.3	27.7	4.18%
Amber MEEF	0.0	11.6	0.96%
Total	**294.2**	**92.0**	**4.31%**

7.3 The Council's approach so far has been to delay replacing maturing loans as they fall due. This will no longer be feasible given the level of borrowing anticipated over the coming years and Council's reserves and balances.

7.4 Table 3 below shows the level of borrowing that could be needed to replace existing loans in the next few years, if options are exercised on bank loans.

Table 3 - Debt maturity

Type (£m)	1	1-2	2-5	5-10	10-20	20-30	30-40	Total
PWLB* & MEEF	3.5	1.4	6.9	19.0	80.6	26.9	118.9	257.2
LOBOs**	42.0	43.5	33.5	0.0	0.0	0.0	10.0	129.0
Total	**45.5**	**44.9**	**40.4**	**19.0**	**80.6**	**26.9**	**128.9**	**386.2**

** fixed maturity date*
*** options to raise rate / repay*

8. Debt Rescheduling

8.1 Table 3 shows that in the next 5 years £11.8m of PWLB / MEEF loans will mature and need replacing.

8.2 While the prospect of LOBO loans being exercised in the near term is currently low, the theoretical value of loans being called in the next 5 years could be £119m. This is monitored within the Treasury Management & Capital Strategy reports during the year.

8.3 Outside of natural maturities, opportunities for rescheduling fixed PWLB loans are currently few, due to the interest rate environment. To repay a PWLB loan early will incur a penalty (much like ending a fixed rate mortgage early) where interest rates are currently lower than the rate that the PWLB is charging for its loan (i.e. the PWLB will attempt to make up any lost interest).

8.4 The Council will continue to monitor the market and opportunities to reschedule, redeem or alter the profile of existing LOBO debt. 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
- enhancing the balance of the portfolio (amend the maturity profile and / or the balance of volatility.

9. Benchmarking

9.1 Chart 5 illustrates how the Council's current level of external borrowing compares with other London boroughs. On average, the level of borrowing across London boroughs, excluding the Council is £412m.

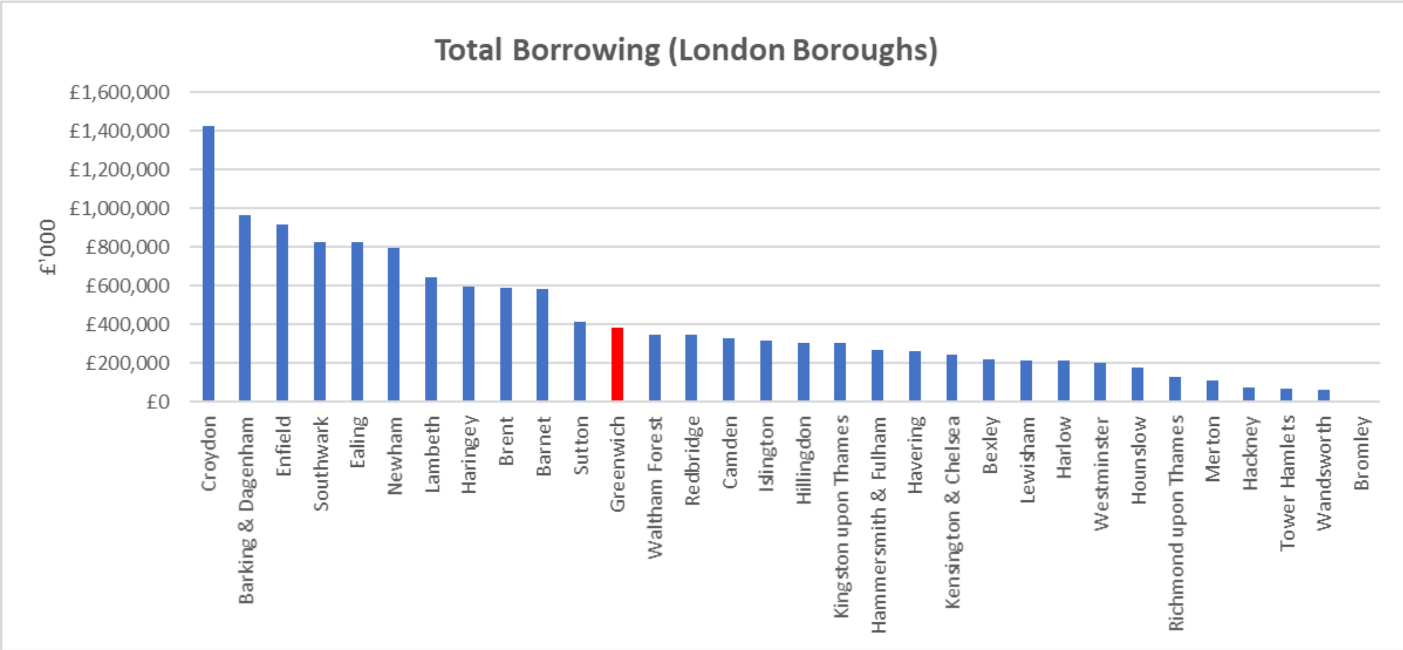

Chart 5: London Boroughs total external borrowing

10. Prospects for Interest rate

10.1 PWLB rates are based on and are determined with reference to Gilt (UK Government bonds) yields through HM Treasury determining a specified margin to add to gilt yields. The main influences on gilt yields are Bank Rate (short term) and inflation (long term) expectations.

10.2 Inflation targeting by the major central banks has been relatively successful over the last 30 years in lowering inflation.

10.3 Chart 6 shows the 25-year PWLB interest rate since the last time that the council undertook general long term borrowing, in 2012.

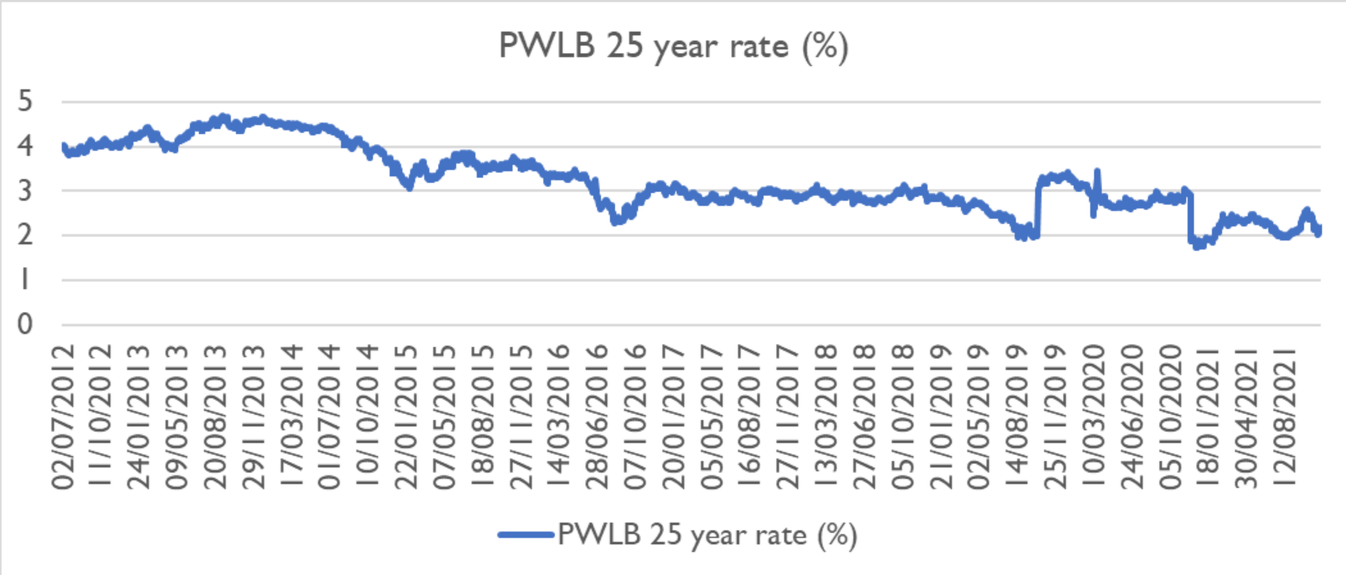

Chart 6: PWLB 25-year rate

10.4 The government reduced the margin it puts on PWLB borrowing in late 2020 (reversing an increase it implemented the previous year). Gilt yields fell sharply from the start of 2020 and then spiked up during a financial markets meltdown in March 2020 caused by the pandemic hitting western countries - this was rapidly countered by central banks flooding the markets with liquidity

10.5 Since the start of 2021 gilt yields and therefore Public Works Loan Board (PWLB) rates have generally risen.

10.6 Chart 7 magnifies the performance from January 2020 to November 2021.

Chart 7: 25-year PWLB - last 24 months

10.7 Whilst the council may not technically need to externalise its debt until 2022/23, refinancing risk remains. If the council is going to borrow £207m over the next two years (and it may not be all in one go and for the same maturity period), then the rate at which it does so is going to be significant. For example, the interest rate (using 25 years as the example) has traded at 2.0% as well as 2.5% and 3% in the last 24 months – the annual interest cost associated with this level of borrowing would be either £4.1m or £5.2m or £6.2m. It would then be this sum each year thereafter. There is thus an overwhelming argument to borrow earlier to mitigate the refinancing risk.

10.8 Link Asset Services is the council's treasury advisor and part of their service is to assist in formulating a view on interest rates. Table 4 provides a three-year view of both the Bank of England rates and PWLB rates. This provides further evidence for borrowing with borrowing rates forecast to rise in 2022.

Table 4 - Interest rates for Borrowing forecasts (Oct 2021)

Forecast* %	2021	2022				2023	2024
	Dec	Mar	Jun	Sep	Dec	Mar	Mar
Bank Rate	0.25	0.25	0.50	0.50	0.50	0.75	1.00
5yr PWLB	1.50	1.50	1.60	1.60	1.70	1.70	1.80
10yr PWLB	1.80	1.90	1.90	2.00	2.00	2.10	2.20
25yr PWLB	2.10	2.20	2.30	2.40	2.40	2.40	2.60
50yr PWLB	1.90	2.00	2.10	2.20	2.20	2.20	2.40

**PWLB forecasts using "Certainty Rate"*

11. Summary

11.1 The uncertainties that come with a large capital programme, whether it will be delivered within the targeted timelines and whether all major projects will go ahead, will all impact this timeline. The extent to which internal borrowing may be possible is also dependent on the extent and timing of council cash balances diminishing. The loan duration will be guided by the shape of the Liability Benchmark curve.

11.2 With PWLB interest rates currently close to record lows, the council needs to consider whether it would be prudent to arrange some or all of the required borrowing now. This is to lock in affordability and protect against interest rate risk i.e. the risk that rising interest rates mean the council's capital programme could no longer go ahead with the current forecast budget without, for example, additional cuts to services to repay larger than expected interest costs.

11.3 The default source of borrowing for local authorities is the Public Works Loans Board. However, there is a range of alternative source of borrowing options. The council will need to take into consideration the nature of the borrowing and whether PWLB best meet that need.

11.4 The intention is to continue to report any new borrowing undertaken through future Treasury and Capital reports.

12. Action taken

12.1 Given the fact that the borrowing projection in table one is showing a need to borrow £63m in this financial year, coupled with a sharp and extremely recent about turn in PWLB borrowing rates, which have been heading to an all-time low due to concern around the impact of the Omicron COVID strain, the council, with advice from the treasury adviser (LINK) has made a loan application to the PWLB.

12.2 The loan application was made for £40m, fixed at 1.37% for 50 years, using the PWLB certainty rate (standard rate minus 20 basis points). This application is still subject to HM Treasury to review and consideration as per normal PWLB loan terms with confirmation due by 8 December 2021.

12.3 There have only been seven occurrences over the last 27 years where borrowing rates have been lower (historical low for the same structure loan was 1.31%). This locks in long term low rate borrowing, which should also be seen in the light of long term inflation assumptions of 2%.

13. Available Options

13.1 Option 1 - note the Review of the Capital Financing Requirement

13.2 Option 2 - note the contents of this report and recommend changes.

14. Preferred Option

14.1 Option 1 – Note the report

15. Reasons for Recommendations

15.1 The report highlights the options available to the Council, in securing borrowing to fund the capital programme and the use of internal and external borrowing to deliver Value for Money.

16. Consultation Results

16.1 No consultation has been undertaken.

17. Cross-Cutting Issues and Implications

Issue	Implications	Sign-off
Legal including Human Rights Act	The Panel is asked to note the borrowing review report. No legal issues arise directly from the report	Azuka Onuorah Head of Legal Services 03/12/2021
Finance and other resources	The Report highlights a framework for which external borrowing is undertaken. Borrowing decisions will be taken following the advice of the Council's external treasury management advisers and will follow the Treasury Management Strategy, in order to minimise risk. There have been substantial benefits from internal borrowing over the last decade but there will now be revenue implications from externalising the debt. The course of action will also reduce refinancing risk within the Capital Financing Requirement. The suggested level of borrowing is within the approved Prudential Indicators for 2021/22.	Damon Cook, Director of Finance, 3 December 2021
Equalities	The decisions recommended in this paper have a remote or low relevance to the substance of the Equality Act. There is no apparent equality impact on end users. Further, given the nature of the report it has a remote or low relevance to the Councils Equity and	Julian Gocool – Accountancy and Business Change Manager 20/08/2021

	Equality Charter and the Council's Equality Objectives.	
Climate change	While the report does not directly include borrowing for climate change projects, future borrowing requirement for green project could be able to utilise the options detailed in the report, subject to an understanding from the government around who is responsible for cost pressures.	Julian Gocool – Accountancy and Business Change Manager 20/08/2021

18. Report Appendices

18.1 The following documents are to be published with and form part of the report:

Appendix 1: Glossary

19. Background Papers

None

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