Chichester District Council

Corporate Governance and Audit Committee 1 September 2020

Local Authority Borrowing

1. Contacts

Report Author
Mark Catlow – Group Accountant
Telephone: 01243 521076 E-mail: mcatlow@chichester.gov.uk

2. Recommendation

The Corporate Governance and Audit Committee is requested to note this report.

3. Background

3.1 Over the last 20 years the Council has funded its Capital Programme and Asset Renewal Programme from the Council's own resources. A resources statement is prepared alongside the Council's financial projections each year and presented to this Committee to demonstrate that capital plans remain affordable.

3.2 The principles underpinning the Council's financial strategy do not require only internal resources to be used, and the Council's current Treasury Strategy does allow for a limited amount of borrowing, principally for operational cash management purposes.

3.3 The Council's key financial principles do, however, contain a requirement to identify revenue savings or external funding before any capital expenditure that has revenue consequences, is approved is important. Any new external borrowing will impose additional revenue pressures and this is explored below.

4. Borrowing

4.1 Local councils have long been able to borrow to fund capital expenditure, but all long term borrowing must be both 'affordable' and 'prudent', as well as being lawful.

4.2 Affordable would include an assessment of both the annual cost of interest on the loan and also the annual cost of setting aside a prudent sum to repay the debt (i.e. the minimum revenue provision, MRP), which is covered separately below.

4.3 To be prudent, we must demonstrate and justify the need to borrow. We could not borrow £20m to invest in something that is still being developed and considered. Any borrowing needs to be based on an approved viable scheme that is included in the Council's capital programme and one that is expected to proceed with reasonable certainty.

4.4 Other important points include:

- The Council must ensure that its total external debt (including leases) does not exceed its calculated capital financing requirement (CFR) and its authorised borrowing ceiling;

- The Council can borrow in advance of need, but only within reason. In this context “Need” is determined by the forward capital programme as approved by Members;

- The Council cannot borrow purely for speculation or return. This is unlawful. Any borrowing must be within the Council’s CFR projections;

- Borrowing cannot be undertaken to fund revenue expenditure. It is possible however temporarily borrow pending the receipt of income (e.g. paying a precept pending receipt of council tax);

- The Council is prevented by law from using Council property as collateral for loans.

5. The Capital Financing Requirement (CFR)

5.1 The CFR is the amount of capital expenditure that has not yet been financed by capital receipts, capital grants or contributions from revenue. Put simply, it is an indication of the Council’s underlying need to borrow for capital purposes.

5.2 In short, if the total capital expenditure in any year is greater than the internal resources applied to fund it (revenue, capital receipts or grants), the capital financing requirement increases by the difference.

5.3 If the Council borrows an amount greater than its calculated CFR, this would indicate it is borrowing more than it needs to and this would potentially be unlawful.

6. Revenue costs

6.1 If the Council has financed capital expenditure by external borrowing, it is required to make a minimum revenue provision (MRP) charge each year against its revenue budget.

6.2 MRP ensures that the Council’s CFR does not increase indefinitely. In effect, MRP largely reduces the borrowing in line with each asset’s life, and so charges the economic consumption of capital assets as they are used.

6.3 There are four options specified to calculate MRP but broadly, the aim is to ensure that MRP is charged over a period that is reasonably commensurate with the period over which the capital expenditure which gave rise to the debt provides benefits.

6.4 In practical terms there are lots of similarities between MRP and depreciation, although they are not the same. The key message is that MRP would be an additional ongoing charge against the Council’s revenue budget alongside the borrowing interest costs.

6.5 To summarise the revenue impact of borrowing, comparing public and private sectors;

- A company with long term assets financed by debt would charge external interest and depreciation against its Profit and Loss account;

- A local authority with the same asset financed by the same debt would suffer Interest and MRP.

7. Sources of external finance

7.1 The Council's Treasury Strategy sets out the approved sources of external finance available to the Council. These are:

- The Public Works Loans Board (PWLB) and any successor body;
- Any institution approved for investments;
- Any other bank or building society authorised to operate in the UK;
- UK public and private sector pension funds (except the West Sussex Pension Fund); and,
- Any other UK public sector body

7.2 The use of alternative or unfamiliar sources of capital finance, such as Tax Increment Financing, or the new Municipal Bonds Agency, would need prior confirmation that they fall within the approved categories above, or an amendment made to the Council's Treasury Strategy.

7.3 The rationales for choosing between these different sources of borrowing would include the administrative ease, interest rates offered by the lender(s) and the repayment period sought by the Council.

8. The Public Works Loan Board

8.1 In recent years the majority of loans taken out by local authorities have been supplied by the Public Works Loan Board (PWLB). This is by far the simplest way for the Council to access loan finance, and up until October 2019, it was also often the cheapest source of finance.

8.2 The PWLB offer 3 types of borrowing; Maturity, EIP and Annuity, each have their own structure and associated rate:

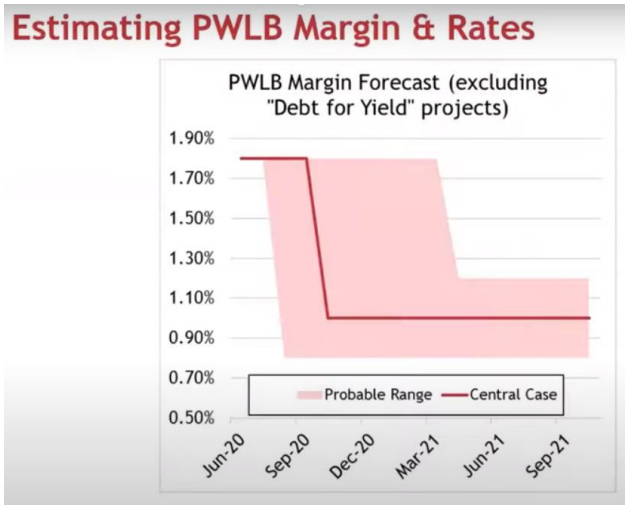
- Maturity: interest payments are made throughout the period of the loan, and the principal borrowed is repaid at maturity;
- EIP: Equal Instalments of Principal pays back principal over the life of the loan, and the interest associated with the loan goes down as the principal outstanding reduces; and,
- Annuity: Equal payments over the course of the loan, with principal paid back over the course of the loan in an increasing amount.

8.3 Worked examples for both EIP and Annuity borrowing is included at Appendix A

8.4 On 9 October 2019 the Government announced a decision to raise the interest rate on new loans from the PWLB by 1% over gilts over and above existing interest rates. This increased the cost of PWLB lending with the intention of discouraging commercial investment by Local Authorities.

8.5 Proposals are currently being consulted on that may reverse some of the increase in interest rates imposed in 2019, subject to Local Government accepting the PWLB limiting (and perhaps ceasing) lending to finance 'commercial income' (debt for yield) type capital expenditure.

8.6 Given the likely and relatively substantial cut in the margin in the relative near term, illustrated by the projection below, the Council's Treasury advisor, Arlingclose Ltd, advises that Chichester holds off long term borrowing until the new PWLB terms are published. In the meantime, borrowing requirements could be met by short term borrowing from other local authorities.



8.7 Even if present margins do not reduce PWLB lending is almost certainly the most straight forward and lowest risk source of capital finance available to the Council.

9. Local Authority Bonds

9.1 UK local authorities have always had the power to issue bonds, although they do require sufficient scale to be worthwhile and cheaper than the PWLB.

9.2 Issues with bond financing include the time taken to issue a bond, the added costs to the local authority (these include acquiring a rating from a rating agency, legal fees, broker fees). Given this, and that the PWLB is readily available, the admin involved in issuing a bond is relatively cumbersome.

10. Local Authority lending

10.1 The Council has frequently lent money to other local authorities. The growth in lending between local authorities is not hard to understand, as they offer some of the best credit risk available to any investor.

10.2 Typically this type of borrowing is short term in nature. Treasury statistics reveal that of £14bn inter LA lending at 31 March 2020, only £2.5bn was long term.

11. Resource and Legal Implications

11.1 None – this paper is for briefing purposes only

12. Consultation

12.1 Not applicable

13. Community Impact and Corporate Risks

13.1 Not applicable

14. Other Implications

Are there any implications for the following? If you tick "Yes", list your impact assessment as a background paper in paragraph 13 and explain any major risks in paragraph 9		
	Yes	No
Crime and Disorder The Council has a duty "to exercise its functions with due regard to the likely effect of the exercise of those functions on, and the need to do all that it reasonably can to prevent, crime and disorder in its area". Do the proposals in the report have any implications for increasing or reducing crime and disorder?		X
Climate Change and Biodiversity Are there any implications for the mitigation of/adaptation to climate change or biodiversity issues? If in doubt, seek advice from the Environmental Strategy Unit (ESU).		X
Human Rights and Equality Impact You should complete an Equality Impact Assessment when developing new services, policies or projects or significantly changing existing ones. For more information, see Equalities FAQs and guidance on the intranet or contact Corporate Policy.		X
Safeguarding and Early Help The Council has a duty to cooperate with others to safeguard children and adults at risk. Do these proposals have any implication for either increasing or reducing the levels of risk to children or adults at risk? The Council has committed to dealing with issues at the earliest opportunity, do these proposals have any implication in reducing or increasing demand on Council services?		
General Data Protection Regulations (GDPR) Does the subject of the report have significant implications for processing data likely to result in a high risk to the rights and freedoms of individuals? Processing that is likely to result in a high risk includes (but is not limited to): • systematic and extensive processing activities and where decisions that have legal effects – or similarly significant effects – on individuals. • large scale processing of special categories of data or personal data relation to criminal convictions or offences. • Any larger scale processing of personal data that affects a large number of individuals; and involves a high risk to rights and freedoms eg based on the sensitivity of the processing activity.		X

• large scale, systematic monitoring of public areas (including by CCTV). Note - If a high risk is identified a Privacy Impact Assessment must be provided to the Data Protection Officer.		
Health and Wellbeing The Council has made a commitment to 'help our communities be healthy and active'. You should consider both the positive and negative impacts of your proposal on the health and wellbeing of communities and individuals living and working in the district. Is your proposal likely to impact positively or negatively on certain groups and their ability to make healthy choices, for example low income families, carers, older people/children and young people. Are there implications that impact on areas of the district differently? eg the rural areas or those wards where health inequalities exist. If in doubt ask for advice from the Health and Wellbeing team.		**X**
Other (please specify)		X

15. Appendices

Appendix 1 – Worked financing examples
Appendix 2 – Summary of borrowing options

16. Background Papers

None

Appendix 1 – Worked examples

Case study 1

Total scheme costs £5,225,000, Financing sought £5,000,000

Return on Capital Employed currently 6%, payback 18.18 years.

Potential Income from scheme once complete £276,250 pa.

Expected lifespan = 60 years, prudent borrowing period set at 30 years (steel framed buildings)

Basis	Annuity	EIP
Interest rate	2.53	2.51
Total Interest Cost	2,204,846	1,945,250
Annual Interest cost	73,494	64,841 (average)
Annual MRP	166,666	166,666
Total revenue charge pa	**240,160**	**231,507**

Case study 2

Total scheme costs £3,300,000. Financing sought £3,000,000

Asset life per asset register:40 years (standard build)

Borowing period 40 years, MRP period 40 years.

Basis	Annuity	EIP
Interest rate	2.67	2.66
Total Interest Cost	1,926,965	1,635,900
Annual Interest cost	48,174	40,875 (average)
Annual MRP	75,000	75,000
Total revenue charge pa	**123,174**	**115,875**

Appendix 2 – Borrowing options summary

The table below covers the main options available to a Local Authority. It is not an exhaustive list.

Source	PWLB	Short term LA	Long term LA	Bank Loan	Municipal Bond Agency	Public Bonds
Size	Any	< £10m	>£10m	> £5m	Unknown	£200m
Period	1 to 50 years	< 1 year	2 to 25 years	< 10 years	Unknown	➢ 10 years
Interest type (1)	V, F	F	V, F	F, V, I	F	F, I
Tradeable	No	No	Possible	Possible	Yes	Yes
Credit assessment	No	No	Yes	Yes	Yes	Yes
Credit rating	No	No	No	No	No	Yes
Legal documentation	No	No	Yes	Yes	Yes	Yes
Process	Easy	Easy	Moderate	Moderate	Intensive	Intensive
Margin	High (2)	Low	Medium	Medium	Medium	High

Source: adapted from information supplied by Arlingclose

Key
(1) Interest: Variable (V), Fixed (F), Inflation linked (I)
(2) Could reduce subject to outcome of present consultation