

TREASURY MANAGEMENT STRATEGY 2020/21

ANNEX C – Borrowing Strategy

1. Introduction

- 1.1 The Borrowing Strategy is prepared in accordance with a professional code of practice (the CIPFA Code of Practice and Cross-Sectoral Guidance Notes on Treasury Management – 2017 Edition).
- 1.2 It includes the following:
- The Council’s debt and investment projections (section 2).
 - The expected movement in interest rates (section 3).
 - The Council’s borrowing strategy (section 4).
 - The Council’s policy on borrowing in advance of need (section 5).
 - The Council’s approach to debt rescheduling (section 6).
 - The Council’s Lender Option Buyer Option (LOBO) strategy (section 7).

2. Debt and Investment Projections 2020/21 – 2022/23

- 2.1 The borrowing requirement comprises the expected movement in the Capital Financing Requirement (CFR in the table below) and any maturing debt which will need to be re-financed. The table below shows this effect on the treasury position over the next three years. It also highlights the expected change in investment balances:

£'000s	2019/20 Revised	2020/21 Projection	2021/22 Projection	2022/23 Projection
External Debt				
Long-term debt at 1 April	96,302	97,909	105,802	108,695
Repaid debt	(7,393)	(2,107)	(7,107)	(3,947)
Replacement of maturing debt	9,000	-	-	-
Additional long-term debt	-	10,000	10,000	20,000
Long-term debt at 31 March	97,909	105,802	108,695	124,748
Short-term debt at 31 March	227,000	300,128	377,783	358,363
PFI and Other Liabilities	101,833	98,674	95,363	91,876
Total external debt at 31 March	426,742	504,604	581,841	574,987
Annual change in debt	72,910	77,862	77,237	(6,854)
Investments				
Total investments at 31 March	(1,000)	-	-	-
Investment change	8,800	1,000	-	-
Change in debt less investment	81,710	78,862	77,237	(6,854)
Annual change in CFR (annex E 3.3)	78,231	50,185	71,568	(6,854)

2.2 The additional long-term debt includes any borrowing in advance and catch-up borrowing. The related impact of the above movements on the revenue budget are:

£'000s	2019/20 Revised	2020/21 Projection	2021/22 Projection	2022/23 Projection
Revenue Budget				
Interest on long-term loans	4,055	4,405	4,755	5,455
Interest on short- term loans	2,284	5,204	8,379	7,990
Total Interest Cost	6,339	9,609	13,134	13,445
General Fund long-term borrowing cost	5,941	9,249	12,531	12,475
HRA long-term borrowing cost	398	360	603	970
Investment income/Internal Financing	(6)	(437)	(410)	(399)

3. Expected Movements in Interest Rates

3.1 Due to the recent general election, the Office of Budget Responsibility has not yet produced their latest forecasts of the Bank of England Base Rate at the time of writing. As a result, the March 2019 forecast has been used in conjunction with the Chicago Mercantile Exchange (CME) Group Bank of England Watch Tool. Due to the uncertain conditions surrounding Brexit and the performance of the economy since the general election, there are indications that the base rate may reduce during 2020, but for the purpose of this strategy, the worst case is assumed and the below rates have been used. Currently, the Bank Base Rate is forecast to remain at 0.75% until the 4th quarter of 2020 when it may increase slowly to 1.00% by the 4th quarter of 2021. Bank Rate forecasts made by the Office of Budget Responsibility in March 2019 are as follows:

- 2019/20 0.75%
- 2020/21 1.00%
- 2021/22 1.00%
- 2022/23 1.10%

3.2 Market expectations of Long Term Interest Rates are estimated to be:

PWLB Certainty Borrowing Rates				
Indicative %	5 Year	10 Year	25 Year	50 Year
2019/20 (actual January 2020)	2.42	2.62	3.10	3.00
2020/21	2.65	2.85	3.25	3.20
2021/22	2.85	3.05	3.45	3.35
2022/23	2.95	3.15	3.65	3.55

3.3 These assumptions have been used to determine the treasury management budget projections, included as part of the 2020/21 General Fund Revenue Budget and future year projections.

- 3.4 Interest rates are expected to continue to remain at low levels throughout the period covered by this report. In an effort to control the threat of inflation on the UK economy the Bank of England increased the base rate on the 3rd August 2018 from 0.50% to 0.75%. Presently, money market investment rates for temporary surplus cash balances are expected to remain at current levels. The present rate for a three-month fixed-term deposit with a high street bank is typically 0.65% but is expected to change in line with changes to the base rate.
- 3.5 Long-term borrowing rates, influenced by gilt yields, are generally stable but Public Works Loan Board rates increased abruptly in October 2019 when the government took the decision to increase the interest rate by 100 basis points. Market expectations are rates will gradually increase towards the end of 2021.

4. Borrowing Strategy

- 4.1 The Council borrows for one of two purposes – to finance cash flow in the short-term or to fund capital investment over the longer term. The Council is currently maintaining an under-borrowed position. This means that the capital borrowing need (the Capital Financing Requirement), has not been fully financed with either long term loans or with temporary borrowing. Instead part of the Capital Financing Requirement has been financed using the Council's reserves and cash balances. This strategy is prudent as investment returns are low and there is a plentiful supply of inexpensive short term finance currently available in the market.
- 4.2 A key aim of the Borrowing Strategy is to minimise the cost of the Council's loan portfolio whilst ensuring that the obligation to repay loans is matched with the benefit received from expenditure incurred on the capital programme.
- 4.3 The average rate of interest on the Council's loan portfolio is currently 1.31%, which is one of the lowest rates of the CIPFA group of authorities that the Council compares itself to. The achievement of such low rates ensures the Council benefits from the best value for money in terms of its borrowing. This is the result of a number of years proactively managing the portfolio on loans through restructuring and taking advantage of inexpensive short term borrowing. The borrowing strategy will continue with this successful approach.
- 4.4 The approved sources of long-term and short-term borrowing will be:
- Public Works Loan Board
 - UK Local Authorities
 - Pension Funds
 - Public Corporations
 - UK Municipal Bond Agency (see paragraph 4.7 below for further details)
 - Any institution approved for investments
- 4.5 As stated above in paragraph 3.4, the interest rate environment continues to be uncertain and the Bank of England expects that interest rates will continue to remain at low levels throughout the period covered by this report. The Treasury Management Panel, under delegated powers, will take the most appropriate form of borrowing in this uncertain economic environment depending on the prevailing interest rates at the time.

- 4.6 In order to secure the lowest cost of borrowing Blackpool Council has agreed to disclose estimates of its capital transactions including new borrowing and planned capital to Her Majesty's Treasury. The disclosure of this information in summary format entitles the Council to receive a 20 basis point discount on all new loans borrowed from the Public Works Loan Board during the next 12 months. The information provided to Her Majesty's Treasury is updated annually.
- 4.7 Along with other local authorities the Council became a shareholder in the UK Municipal Bond Agency (UK MBA) and is part of the UK Municipal Bond Agency Working Group. The council saw this as a viable alternative to borrowing from the Public Works Loan Board. At the time of writing, the UK Municipal Bond Agency has not issued its first bond in the market, however this is expected to change in the near future.

5. Policy On Borrowing In Advance Of Need

- 5.1 The Council will not borrow more than or in advance of its needs, purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be within forward approved Capital Financing Requirement estimates, and will be considered carefully to ensure value for money can be demonstrated and that the Council can ensure the security of such funds.
- 5.2 In determining whether borrowing will be undertaken in advance of need the Council will:
- ensure that there is a clear link between the capital programme and maturity profile of the existing debt portfolio, which supports the need to take funding in advance of need;
 - ensure the ongoing revenue liabilities created, and the implications for the future plans and budgets have been considered;
 - evaluate the economic and market factors that might influence the manner and timing of any decision to borrow;
 - consider the merits and demerits of alternative forms of funding;
 - consider the alternative interest rate bases available, the most appropriate periods to fund and repayment profiles to use;
 - consider the impact of borrowing in advance (until required to finance capital expenditure) increasing investment cash balances and the consequent increase in exposure to counterparty risk and the level of such risks given the controls in place to minimise them. Any risks arising will be reported via the mid-year or annual reporting mechanism.

6. Debt Rescheduling

- 6.1 The introduction by the Public Works Loan Board (PWLB) in 2007 of a spread between the rates applied to new borrowing and repayment of debt (which has now been compounded since 20 October 2010 by a considerable further widening of the difference between new borrowing and repayment rates) has meant that PWLB to PWLB debt restructuring is now much less attractive than before these events. In particular, consideration would have to be given to the large premiums, which would be incurred by prematurely repaying existing PWLB loans and it is very unlikely that these could be justified on value for money grounds if using replacement PWLB refinancing. However, some interest savings may still be achievable through using other local authority loans and market loans in rescheduling exercises rather than using PWLB borrowing as the source of replacement financing.

- 6.2 As short term borrowing rates are currently considerably 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, these savings will need to be considered in the light of the current treasury position and the size of the cost of debt repayment (premiums incurred).
- 6.3 The reasons for any rescheduling to take place will include:
- (a) The generation of cash savings and / or discounted cash flow savings;
 - (b) Help fulfil the borrowing strategy outlined above;
 - (c) Enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).
- 6.4 Consideration will also be given to identify if there is any residual potential for making savings by running down investment balances to repay debt prematurely as short term rates on investments are likely to be lower than rates paid on current debt.
- 6.5 Any decision taken on rescheduling existing long term debt will be made by the Treasury Management Panel.

7. Lender Option Borrower Option debt (LOBOs)

- 7.1 LOBOs typically carry a cheaper initial rate of interest than new debt available from other sources. They are structured with an initial period in which a fixed rate of interest is paid, followed by a much longer 'variable' period. During this period at the agreed 'call' dates (typically between every six months to every five years) the Lender has the option to increase the interest rate. If the Lender exercises their Option to increase the rate, the Borrower has the Option to repay the debt.
- 7.2 When general interest rates are rising, the interest the Council pays on its LOBOs will tend to ratchet up at call dates, lagging just below other available market rates. The higher rate chosen by the lender is always likely to be enticingly below other immediately available market rates so that at the decision points when the borrower has the option to repay, it will be seduced into a longer relationship with the LOBO at higher rates. However, when general interest rates are falling, the interest the borrower pays on its LOBOs will remain fixed at the higher rates.
- 7.3 The Treasury Management Panel notes that whenever a lender calls an increase in the rate of a LOBO there will be a great temptation to accept the higher rate and remain tied into the LOBO (as the alternative borrowing is likely to be slightly more expensive in the short term). The Council will continue to take advantage of the beneficial rates available through LOBOs as part of a balanced portfolio of fixed and variable debt, especially through the early fixed period of the instrument.
- 7.4 The Council's policy is that on every occasion when a lender opts to increase the interest rate on one of its LOBOs there is a presumption that the Council will repay the LOBO.
- 7.5 In view of the recent bad press on LOBOs the Treasury Management Panel is looking for ways to redeem them whenever favourable opportunities arise. In 2019/20 the Treasury Management Panel attempted to buy out a large proportion of the Council's LOBO portfolio, however this proved to be financially unviable as a result of the large premiums charged on repaying the loans early.