TREASURY MANAGEMENT STRATEGY 2022/23

APPENDIX 5c – Borrowing Strategy

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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 – 2021 Edition). Revised reporting requirements from the newly published 2021 Edition of the guidance notes including changes to prudential indicators and investment reporting will be included within the 2023/24 Strategy.

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 2021/22 – 2023/24

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	2021/22 Revised	2022/23 Projection	2023/24 Projection	2024/25 Projection
External Debt				
Long-term debt at 1 April	86,341	79,234	95,320	101,307
Repaid Debt	(7,107)	(3,914)	(4,013)	(4,640)
Replacement of maturing debt	-	20,000	10,000	-
Additional long-term debt	-	-	-	-
Long-term debt at 31 March	**79,234**	**95,320**	**101,307**	**96,667**
Short-term debt at 31 March	330,028	386,554	474,064	520,062
PFI and Other Liabilities	95,842	93,390	90,633	87,834
Total external debt at 31 March	**505,104**	**575,264**	**666,004**	**704,563**
Annual change in debt	**76,288**	**70,160**	**90,740**	**38,559**
Investments	(1,000)	-	-	-
Total investments at 31 March	**(1,000)**	**-**	**-**	**-**
Investment change	**(22,350)**	**1,000**		
Change in debt less investment	53,938	71,160	90,740	38,559
Annual change in CFR (annex E 3.3.)	**27,088**	**73,306**	**89,145**	**32,673**

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	2021/22 Revised	2022/23 Projection	2023/24 Projection	2024/25 Projection
Revenue Budget				
Interest on long-term loans	3,577	4,096	4,304	4,220
Interest on short-term loans	786	2,513	4,030	4,421
Total Interest Costs	**4,363**	**6,609**	**8,334**	**8,641**
General Fund long-term borrowing cost	3,259	3,624	3,482	3,074
HRA long-term borrowing cost	318	472	822	1,146
Investment income/internal financing	-	-	-	-

3. Expected Movements in Interest Rates

3.1 The Bank of England Base Rate increased the base rate in December 2021 from a historical low of 0.10% to 0.25%. Rates are expected to increase to 0.50% before the end of the financial year, eventually increasing to the prepandemic level of 0.75% in 2023/24. The Bank Rate forecasts produced by the Office of Budget Responsibility in November 2021 are as follows:

- 2021/22 0.25%
- 2022/23 0.50%
- 2023/24 0.75%
- 2024/25 0.75%

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**
2021/22 Actual (December 2021)	1.74%	1.93%	2.17%	1.84%
2022/23	1.99%	2.18%	2.42%	2.09%
2023/24	2.24%	2.43%	2.67%	2.34%
2024/25	2.24%	2.43%	2.67%	2.34%

3.3 These assumptions have been used to determine the treasury management budget projections, included as part of the 2022/23 revenue budget and future year projections.

3.4 The Covid-19 pandemic has delivered the largest shock to the UK and global economies in living memory. In March 2020, the base rate was reduced from 0.75% to 0.25% and then reduced again 8 days later to 0.10%. The uncertain course of the pandemic and its severe impact on the economy mean that interest rates continue to remain at low levels, but due increasing inflationary pressure the Bank of England increased the base rate in December 2021 to 0.25%. Presently, money market investment rates for temporary surplus cash balances are expected to increase in line with future base rate increases. The present rate for a three-month fixed-term deposit with a high street bank is typically 0.01%.

3.5 Long-term borrowing rates, influenced by gilt yields, have remained low for much of 2021/22. In November 2020 along with issuing new conditions of accessing the PWLB, including that PWLB loans cannot be taken to purchase investment assets primarily for yield. Market expectations are that long-term rates will gradually increase towards the end of 2022 in line with the base rate.

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 either with 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 minimize 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 1.05%, which is one of the lowest rates of the CIPFA group of authorities that we compare ourselves 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 borrow from the PWLB, the council must submit a high-level description of capital financing plans for the following three years. As part of this, to be granted a loan the Director of Resources must confirm there is no intention to buy investments primarily for yield at any point within the next three years regardless of whether the transaction would be notionally financed from a source other than the PWLB. 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 MBA Working Group. The council saw this as a viable alternative to borrowing from the PWLB. The UK MBA issued its first bond on 5th March 2020 on behalf of Lancashire County Council for a total of £350 million and then a further £250 million bond issuance was completed in August 2020.

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 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 LOBO's the Treasury Management Panel is looking for ways to redeem them whenever favourable opportunities arise.