

Audit and Governance Committee

Monday, 22 February 2021

Review of the Council's Borrowing

For Decision

Portfolio Holder: Cllr G Suttle, Finance, Commercial & Capital Strategy

Local Councillor(s): All

Executive Director: A Dunn, Executive Director, Corporate Development

Report Author: David Wilkes
Title: Service Manager (Treasury and Investments)
Tel: 01305 224119
Email: david.wilkes@dorsetcouncil.gov.uk

Report Status: Public

Recommendation:

That the Committee note and comment upon the report.

Reason for Recommendation:

To better inform members of the Council's borrowing position and activity in accordance with the requirement to ensure money and resources are used wisely.

1. Executive Summary

This report provides an update on the Council's borrowing position and activity as at 31 January 2021.

2. Financial Implications

This report summarises the Council's borrowing position and activity in the financial year to date. There are no other financial implications arising from this report.

3. Well-being and Health Implications

There are no well-being and health implications arising from this report.

4. Climate implications

There are no well-being and health implications arising from this report.

5. Other Implications

There are no other implications arising from this report.

6. Risk Assessment

Having considered the risks associated with this decision, the level of risk has been identified as:

Current Risk: HIGH

Residual Risk: Medium

Borrowing is an inherently risky area of activity and a number of controls are embedded in its operation. The key borrowing risks are highlighted as part of the capital strategy and treasury management strategy approved by Council as part of the budget setting process.

7. Equalities Impact Assessment

There are no equalities implications arising from this report.

8. Appendices

Appendix 1: Outstanding Borrowing as at 31 January 2021.

9. Background Papers

Dorset Council Capital Strategy 2020/21

Dorset Council Treasury Management Strategy 2020/21

A&G Treasury and Banking Update November 2020

10. Introduction

10.1 Local authorities may borrow to fund capital expenditure not yet permanently financed or to cover temporary cashflow shortfalls.

10.2 All capital expenditure not financed from external sources (government grants and other contributions) or the Council's own resources (revenue, reserves and capital receipts) leads to a borrowing requirement.

10.3 The total of all the Council's past capital expenditure less total financing

applied other than debt is known as the Capital Financing Requirement (CFR) – the Council’s underlying need to borrow.

- 10.4 Debt is only a temporary form of finance as loans must be repaid, and this is therefore replaced over time by other financing, usually from revenue which is known as Minimum Revenue Provision (MRP) or from the proceeds of selling capital assets (capital receipts).
- 10.5 The CFR increases with any new debt-financed capital expenditure and reduces with MRP and any capital receipts used to replace debt.
- 10.6 The Council’s borrowing activity is conducted within the framework of CIPFA’s Prudential Code for Capital Finance and Treasury Management Code of Practice. All borrowing decisions are made within the parameters of the Capital Strategy and Treasury Management Strategy approved by full Council as part of the Budget Strategy report.
- 10.7 The main objective when borrowing has been to strike a balance between securing low interest costs and achieving cost certainty over the period for which funds are required, with flexibility to renegotiate loans should long-term plans change a secondary objective.
- 10.8 With short-term interest rates remaining much lower than long-term rates, it continues to be more cost effective in the near term to use internal resources or borrow rolling short-term loans instead of committing to long term agreements. This strategy has enabled the Council to reduce net borrowing costs (after foregone investment income) and to reduce overall treasury risk but a balanced portfolio of short and long-term borrowing has been maintained.
- 10.9 In order to reduce risk and keep interest costs lower than they would otherwise have been the Council uses balances and reserves (internal borrowing) to keep external borrowing below the CFR rather than investing those balances and reserves in full.

11. Borrowing as at 31 January 2021

- 11.1 At 31 January 2021 the Council held £210.5m of loans summarised in Table 1 below and a schedule of all outstanding loans in Appendix 1.

Table 1: Summary of borrowing at 31 January 2021

	PWLB	Local Authorities	Banks	Other Lenders	Total
	£m	£m	£m	£m	£m
Fixed Term Maturity	81.8	25.0	25.6		132.4
Fixed Term Annuity	2.6	-	-	-	2.6
LOBOs	-		11.0	19.5	30.5
Other Borrowing	-			45.0	45.0
Total	84.4	25.0	36.6	64.5	210.5

- 11.2 The Council can and has borrowed from a variety of lenders including central government (through the PWLB), other local authorities and other public bodies, banks and other corporate bodies. The type of borrowing can also vary:
- 11.3 **Fixed Term Maturity:** The majority of the Council's borrowing (£132.4m) is fixed term maturity. A fixed interest rate is applied at each payment date and the principal is repaid in full at the maturity date.
- 11.4 **Fixed Term Annuity:** The Council holds two holds two fixed term annuity loan agreements with a combined outstanding value of £2.6m. All payments are fixed but the principal repaid increases and interest charges reduce at each payment date.
- 11.5 **Lender's Option Borrower's Option (LOBOs):** The Council holds £30.5m of Lender's Option Borrower's Option (LOBO) loans. The lender has the option to propose an increase in the interest rate at set dates, following which the Council has the option to either accept the new rate or to repay the loan at no additional cost. To date no lenders have exercised their options on these loans.
- 11.6 **Other Loan Agreements:** The Council holds two 'other' loan agreements with a combined outstanding value of £45m. The rate of interest on both loans is fixed until the first option date (after 25 years) at which point the lender can request repayment in full having given six months' notice. The lender then has further options to request repayment at five yearly intervals thereafter until the loans mature.

12. Maturity Structure of Borrowing

- 12.1 The Treasury Management Strategy mitigates the Council's exposure to refinancing risk by setting limits on how much debt can mature at any one time. Current borrowing against those limits is summarised in the table below:

Table 2: Maturity structure of borrowing at 31 January 2021

	Actual £m	% of Total Borrowing	Upper Limit	Lower Limit	Complied Yes/No
Under 12 months	30.5	14.5%	25%	0%	Yes
12 Months to 2 Years	1.0	0.5%	25%	0%	Yes
2 Years to 5 Years	11.1	5.3%	25%	0%	Yes
5 Years to 10 Years	10.0	4.8%	35%	0%	Yes
10 Years to 15 Years	19.5	9.3%	35%	0%	Yes
15 Years to 20 Years	0.0	0.0%	35%	0%	Yes
20 Years to 25 Years	0.0	0.0%	45%	0%	Yes
25 Years to 30 Years	0.0	0.0%	45%	0%	Yes
30 Years to 35 Years	41.8	19.9%	45%	0%	Yes
35 Years to 40 Years	15.0	7.1%	45%	0%	Yes
40 Years to 45 Years	0.0	0.0%	45%	0%	Yes
45 Years to 50 Years	56.0	26.6%	45%	0%	Yes
50 Years and above	25.6	12.2%	75%	0%	Yes
Total	210.5	100.0%			

13. Early Repayment of Borrowing

- 13.1 Long term loan agreements generally include clauses allowing for the early repayment of borrowing to the lender. These clauses typically have mechanisms for calculating a premium (or discount) to compensate the lender (or borrower) for their loss of interest over the remaining life of the loan.
- 13.2 These premia or discounts are calculated based on the difference between the rate of interest in the agreement and current comparable rates of interest available for the remaining life of the loan. Premia will be at their highest when current interest rates are significantly lower than in the agreement and the loan also has a long remaining life.
- 13.3 The schedule of borrowing at Appendix 1 includes the estimated premia for early repayment.
- 13.4 In April 2019 two LOBO loans totally £20m were repaid for a combined premium of £9.2m, delivering estimated annual revenue savings of £150k.

There have been no other early repayments of borrowing since the inception of Dorset Council.

14. Treasury Management Advisers

- 14.1 The Council employs professionally qualified and experienced staff with responsibility for making borrowing and investment decisions supported by external advisers. The Council currently employs Arlingclose as treasury management advisers.
- 14.2 This approach ensures that the Council has access to a wide pool of relevant market intelligence, knowledge and skills, that would be very difficult and costly to replicate internally. However, whilst advisers provide support to the internal treasury function, final decisions on treasury matters always remain with the Council.

Footnote:

Issues relating to financial, legal, environmental, economic and equalities implications have been considered and any information relevant to the decision is included within the report.