Essex County Council

	AGENDA ITEM 5
	CSC / 31 / 18
Report title: Borrowing	
Report to Corporate Policy and Scrutiny Committee	
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Date of meeting: 31 July 2018	**For:** Information
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Divisions affected: All Essex	

1. Purpose of report

1.1 The Committee has requested information on why the Council has to borrow and its strategy for doing so, and on the costs of borrowing. This report is provided in response to this request.

2. Recommendations

2.1 None – the report is for information only.

3. Powers to borrow

3.1 Local authorities are given their general powers to borrow by Section 1 of the **Local Government Act 2003**. The 2003 Act specifies that local authorities may borrow money:

- For any purpose relevant to their functions under any enactment; or
- For the purpose of the prudent management of their financial affairs.

3.2 Whilst these provisions appear to give authorities wide scope to borrow (i.e. provided the borrowing will reasonably assist with the prudent management of the authority's financial affairs), in practice they mean that an authority can only borrow:

- in the short term for **cash flow management purposes**; and
- in the medium term for **capital investment purposes**.

3.3 The statutory provisions for borrowing are supported by additional specific requirements in the **CIPFA Prudential Code for Capital Finance in Local Authorities** (the Prudential Code). The Prudential Code provides the framework that enables councils to determine the level of their capital investment – and how much they borrow to finance that investment – based on their own assessment of what they can afford, not just for the current year but also for future years.

3.4 To demonstrate compliance with the regulatory requirements established by the 2003 Act, and with those of the Prudential Code, the Council is required to produce an annual **Capital Strategy**. The Capital Strategy comprises a number of inter-related elements:

- Capital expenditure (capitalisation policies, governance and capital expenditure plans);
- Capital financing requirement and borrowing limits;
- Investment strategy;
- Commercial investments;
- Treasury management policies and practices

3.5 The overriding purpose of the Capital Strategy is to demonstrate that the Council properly takes account of stewardship, value for money, prudence, sustainability and affordability when determining the level of its capital investment and the extent to which that investment is funded from borrowing.

3.6 The annual Capital Strategy is subject to approval by full Council (as part of the Council's budget setting); the 2018/19 Capital Strategy is published in the Essex County Council Organisation Plan – 2018/19.

3.7 Whilst the framework outlined in the previous paragraphs is predicated on self-regulation, the 2003 Act gives the Secretary of State reserve powers to impose borrowing restrictions on local authorities. So far, the Secretary of State has not used this power but could do so in the future if it considers that any local authority is borrowing imprudently.

4. Capital Financing Requirement and External Borrowing

4.1 When the Council decides to incur capital expenditure that it will finance from 'borrowing', this means that it is incurring expenditure now that it will charge to the revenue budget incrementally over a number of years into the future. It needs to secure external loans to manage the cash flow implications of these decisions.

4.2 The **Capital Financing Requirement** (CFR) provides a measure of the amount of capital expenditure that the Council has already incurred that has yet to be charged to the revenue budget. The CFR amounted to **£992.4m** as at **31st March 2018** (***£845.2m*** *when credit arrangements, such as Private Finance Initiative and finance lease liabilities, are excluded*).

4.3 Looking ahead, the Council's capital programme for 2018/19 originally amounted to **£299m**, and the indicative programme for the subsequent two years totals **£562m**, split as follows:

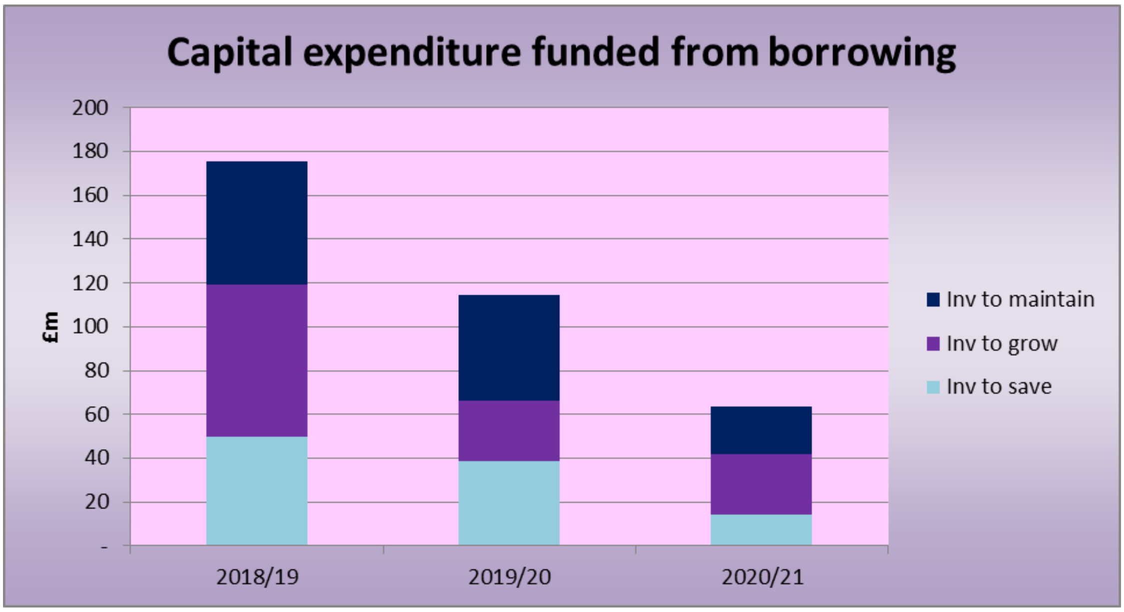
Category of spend	2018/19 £m	2019/20 £m	2020/21 £m	Total £m
Invest to maintain	97	87	82	**266**
Invest to grow	148	171	134	**453**
Invest to save	54	67	21	**142**
Total Capital Expenditure	**299**	**325**	**237**	**861**

4.4 **Invest to maintain** schemes are those where we are maintaining (but extending the life of) our existing assets (e.g. highways and the flood programme).

4.5 **Invest to grow** schemes include those where we are expanding our capacity (e.g. economic growth schemes in infrastructure and highways, creating new school places, new housing developments and enhancing skills in key growth areas).

4.6 **Invest to save / generate return** projects include areas where we are investing to generate a return or saving (e.g. accommodation for older people and people with disabilities, LED lighting and the Essex Housing Programme).

4.7 The Council has already determined that **£176m** of the 2018/19 original programme will be financed from borrowing, rising to **£353m** when the indicative programmes for the subsequent two years are taken into account:



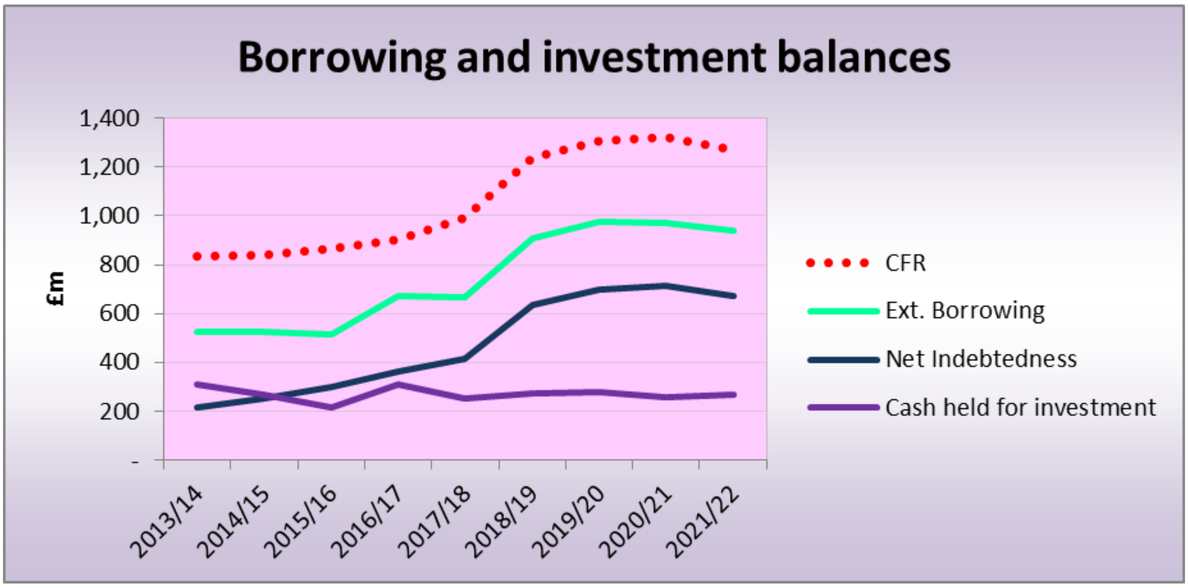
4.8 As a consequence of these projections, it is anticipated that the CFR will amount to **£1.321bn** by 31st March 2021 (**£1.109bn** excluding credit arrangements).

4.9 The Council is only permitted to borrow externally up to the level implied by its CFR. To ensure that external borrowing does not exceed the CFR, other than in the short term, limits are established for external debt, as follows:

- **Authorised limit** – this defines the maximum amount of external debt permitted by the Council;
- **Operational boundary** – this is an estimate of the probable level of the Council's external debt, and provides the means by which external debt is managed to ensure that the authorised limit is not breached.

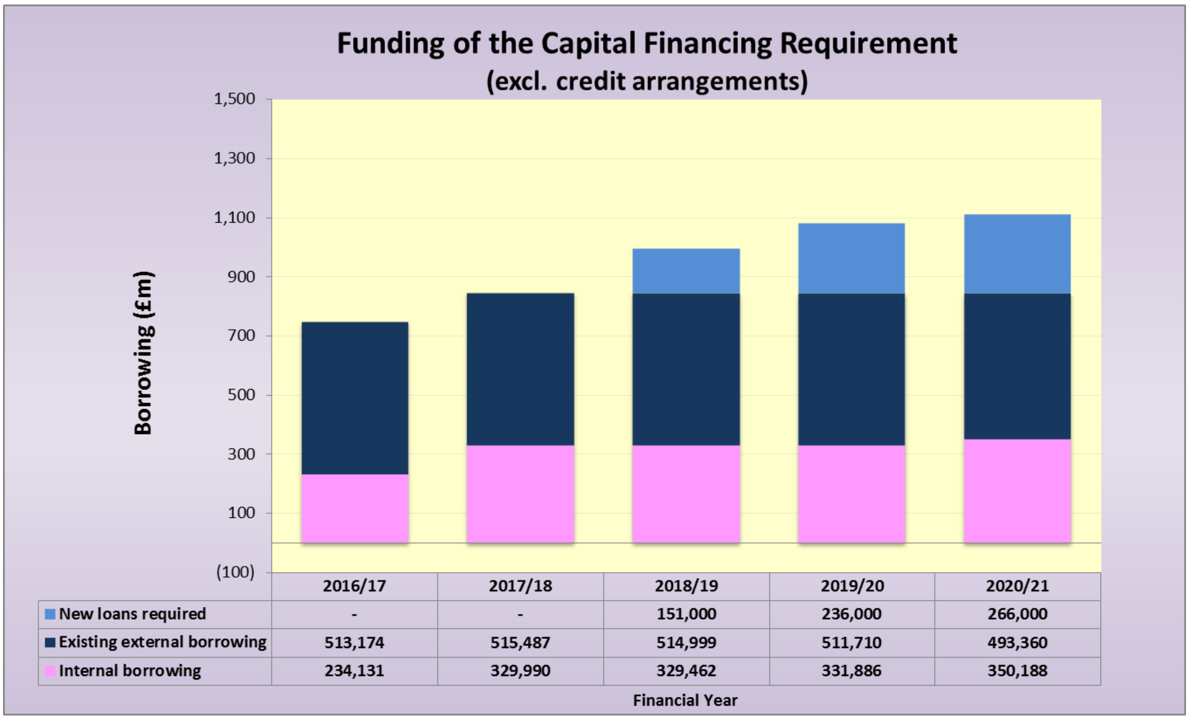
4.10 At 31st March 2018, external borrowing totalled **£515m** (equating to around **60%** of the actual CFR for external borrowing at the same date). This position was sustainable because the Council was able to temporarily utilise some of the cash balances that it has set aside for other purposes (such as in earmarked reserves and balances) as an alternative to external borrowing (a practice referred to as 'internal borrowing').

4.11 The following graph compares the forecast of the CFR over the medium term, with the forecast of external borrowing and net indebtedness.



4.12 Whilst this graph shows that the Council has some scope to reduce the cash held for investment to partly mitigate the need for further external borrowing over the next few years, it is currently assumed that some cash will be held for investment, partly to maintain a degree of liquidity, but also to provide flexibility to secure the new loans when it is most advantageous to do so.

4.13 On the assumption that cash balances held for investment are maintained at their current level over the next few years, additional external borrowing will be required annually, at a level equivalent to the annual increases in the CFR:



	2016/17	2017/18	2018/19	2019/20	2020/21
New loans required	-	-	151,000	236,000	266,000
Existing external borrowing	513,174	515,487	514,999	511,710	493,360
Internal borrowing	234,131	329,990	329,462	331,886	350,188

4.14 External borrowing is therefore anticipated to increase from **£515m** currently, to **£760m** by the end of 2020/21 (based on the current capital expenditure forecast).

4.15 As noted above, **£142m** of the additional borrowing is for 'invest to save' projects that will generate a return on the capital sum invested.

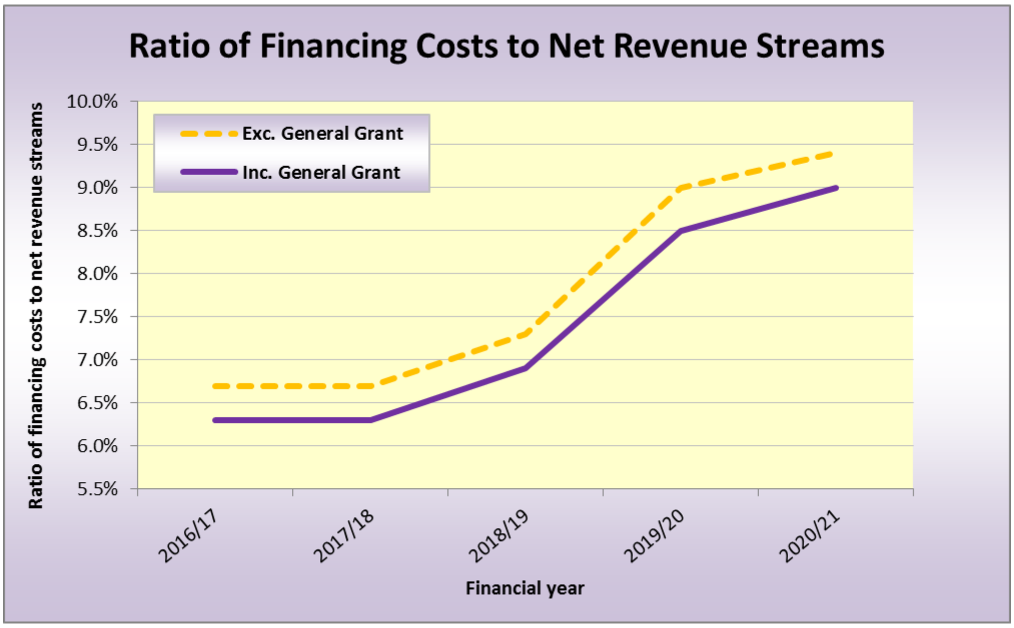
5. Costs of borrowing

5.1 The revenue costs of financing capital expenditure from borrowing are twofold:

- **Principal repayments** (referred to as 'revenue provision for the repayment of debt' or 'minimum revenue provision' (MRP)); and
- **Interest** payable on external loans (*or interest foregone as a consequence of using cash balances to defer external borrowing rather than hold those balances for investment*).

5.2 Statutory guidance requires the principal repayments (MRP) to be provided annually on a 'prudent' basis – this usually means over a period commensurate with the period the capital expenditure provides benefit.

5.3 The proportion of the revenue budget required to fund borrowing costs will increase from **6.3%** in 2017/18 to an estimated **9.0%** by 2020/21:



5.4 However, around **30%** of our planned capital investment is focussed on schemes that will generate savings or achieve economic growth. The additional income and/or savings from these schemes is estimated at **£2.7m** in 2018/19.

6. List of Background Papers

6.1 **Essex County Council Organisation Plan – 2018/19** (note that the 2018/19 Capital Strategy is included within this document).

http://www.essex.gov.uk/Your-Council/Strategies-Policies/Documents/ORGANISATION%20PLAN.pdf