Division(s): n/a

STRATEGY & PARTNERSHIPS SCRUTINY COMMITTEE

THURSDAY 21 JULY 2011

LONG TERM DEBT POLICY

Report by Assistant Chief Executive and Chief Finance Officer

Introduction

1. This report sets out the reasons that Oxfordshire County Council makes use of a Long Term Debt portfolio, the current policy on Long Term Debt and Borrowing and the possible implications of keeping or amending the current policy.

Use of Long Term Debt

2. The Council uses long term debt in order to help finance its capital programme. The schemes within the Capital Programme are funded from a variety of sources, including grants, capital receipts, developer contributions, revenue contributions and long term borrowing.

3. Using long term borrowing allows the Council to spread the cost of financing over long term periods. As the benefits derived from Capital Schemes are long term in nature, it may be deemed more appropriate to finance these schemes over a longer term period.

4. Long Term “Supported” Borrowing for new debt taken prior to April 2011 attracts an additional Government Grant to finance the extra revenue costs associated with borrowing. Whereas borrowing to help finance Prudential Schemes is unsupported and the Council bears the full financing cost.

5. From April 2011 the Supported Borrowing Grant to assist with financing costs for new debt was stopped. In its place the Council will receive a Capital Grant to assist in financing “supported” Capital Schemes. Therefore from April 2011 onwards, the Council will have to bear the full financing costs of any new borrowing undertaken.

Level of Debt

6. The CIPFA Prudential Code for Capital Financing in Local Authorities sets out the maximum level of borrowing that an Authority may undertake, this is known as the Capital Financing Requirement. An example of how the Capital Financing Requirement is calculated is shown on Annex 1.

7. The Capital Financing Requirement is linked to the total value of the Council's assets and acts as a control to ensure that the Council does not borrow more than the value of its assets.

Debt Management

8. The Local Government Housing Act 2003 gives local authorities the power to borrow up to their "affordable borrowing limit", however the Local Government Act 2003 precludes local authorities from mortgaging, or granting charges against its properties as security for money borrowed. Instead debt is secured against the Council's future revenue streams.

9. The Council manages its debt portfolio as a single debt pool; individual loans are not matched to individual properties or assets. Managing the debt as a pool means that the Council avoids premature repayment costs when an asset is disposed of. It also avoids being forced to repay debt which may be on more favourable terms than those currently available. Additionally, the administrative burden is lessened by managing debt in one pool.

Debt Repayment

10. The majority of the Council's debt portfolio is in maturity loans from the Public Works Loans Board (PWLB), meaning that interest is paid on the principal balance of the loan until the final termination date of the loan, whereupon the principal balance is repaid.

11. At present the Council has a policy of replacing maturing debt in the year in which it matures, however irrespective of the replacement policy, the Council is required by statute to charge a Minimum Revenue Provision (MRP) to the Income and Expenditure account each year for the repayment of debt. The MRP is deducted from the Capital Financing Requirement to reduce the total level of debt.

12. As the loans within the debt portfolio are not directly linked with individual assets, the maturity date of a loan does not necessarily indicate that an asset has been disposed of; it indicates a need to refinance.

13. An example of this could be where the Capital Financing Requirement indicated a need to borrow £20m to fund a capital scheme with a useful life of 60 years. Depending on the PWLB "yield curve"[1], it may be more cost effective to borrow the £20m for 10 years, and refinance the loan at that point rather than borrow for 60 years from the outset. An example of the PWLB "yield curve" can be found at Annex 2.

[1] The "yield curve" is a graphical representation of the interest percentage payable on loans of increasing maturity dates. The PWLB yield curve shows the interest percentage payable on loans from 6 months to 50 years.

14. In the above example the asset still exists, and the useful life has not expired. If the loan were not refinanced after 10 years, the repayment of the loan would have to be financed from revenue or another source of finance.

15. The Treasury Management Strategy Team continually monitors the interest rates payable on debt, and will decide the most appropriate source of funding the capital financing requirement. The three main sources of funding are from the PWLB, money market loans or the temporary use of internal balances.

Disposal of assets

16. If the Council disposes of an asset and replaces it with a new asset, then the capital financing requirement remains. In effect, the financing of the old asset is used for the financing of the new asset.

17. If the Council disposed of assets and did not replace them, then the total value of the Councils assets would fall. As the total value of assets falls, then so would the capital financing requirement, and debt would need to be repaid.

18. If the capital financing requirement falls as result of a disposal of assets, then the repayment of debt will need to be funded from revenue, capital receipts or another source, dependant on the nature of the disposal. If the disposal is as a result of the sale of an asset, then it would be most appropriate to use a proportion of the capital receipt to repay debt.

Timing of Financial Burden

19. Where there is a capital financing requirement for a long term capital scheme, using debt to finance it means that the financial burden to the tax payer is spread equally along the life of the asset. If the Council were to use revenue finance to fund long term schemes, the taxpayer would bear the full financial burden of the scheme in the first year.

20. Using revenue to finance capital schemes would also reduce the available revenue budget for spend in other areas in that financial year.

RECOMMENDATION

21. **The Scrutiny Committee is invited to consider the report and offer any comments.**

SUE SCANE
Assistant Chief Executive and Chief Finance Officer

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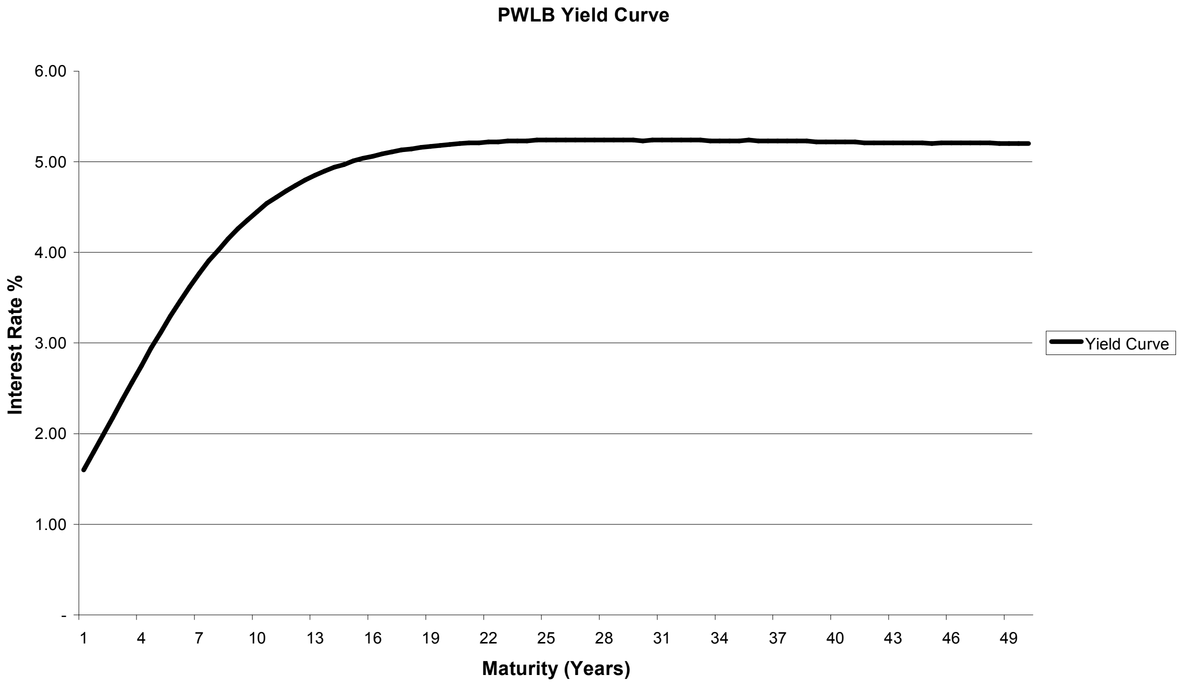
Annex 1

The Capital Financing Requirement (CFR) at 31st March 2010

		IFRS Transition Balance Sheet 31-Mar-10 £
Property, Plant and Equipment		1,497,169,000
Investment Property		4,653,000
Assets Held for Sale		5,357,000
Intangible Assets		5,056,000
Long Term Debtors in relation to Capital		8,212,000
		1,520,447,000
Less		
Revaluation Reserve	(78,267,000)	
Capital Adjustment Account	(990,326,000)	
		(1,068,593,000)
Capital Financing Requirement 31 March 2010		**451,854,000**
Capital Expenditure Funded by Borrowing in 2010/11		30,447,000
Less Minimum Revenue Provision		(17,892,058)
Capital Financing Requirement for 2010/11		**464,408,942**
Long term external debt as at 31 March 2010		412,092,618
Use of Internal balances as at 31 March 2010		12,976,758
Debt balance b/f		425,069,376
Loans maturing during the year		(12,000,000)
Replacement of maturing loans		12,000,000
New borrowing (balancing figure)		39,339,566
Use of Internal Balances		
Total Debt (External and Internal)		**464,408,942**

Annex 2


PWLB Yield Curve
6.00
5.00
4.00
3.00
2.00
1.00
-
Interest Rate %
1
4
7
10
13
16
19
22
25
28
31
34
37
40
43
46
49
Maturity (Years)
Yield Curve