Appendix A

Shetland Islands Council

Borrowing Policy & Strategy

2013-2018

Securing the best for Shetland

Contents

Introduction

Treasury Management

1.01 Treasury Management is defined as the management of an organisation's investments, cash flows, banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks.

1.02 This definition is intended to apply to all public service organisations in their use of capital project financings, borrowings and investments.

1.03 Each year Shetland Islands Council is required to agree its Treasury Management Strategy Statement (TMSS) in order to comply with legislation and the CIPFA Treasury Management Code. This requirement has traditionally been fulfilled as an extension of the annual Investment Strategy document. However, the TMSS has not included any information on borrowing as the Council has a 20 year long standing policy of wishing to remain debt free.

1.04 This Borrowing Policy & Strategy document has been produced to fill that gap so that the Council can in future use borrowing as a tool within its overall Treasury Management arrangements.

Shetland Islands Council's Treasury Management Governance Arrangements

1.05 This will mean that from now on, the Council's Treasury Management arrangements will be covered by:

- An annual Treasury Management Strategy Statement which will fulfil the requirements of the CIPFA Treasury Code;
- An annual Investment Strategy;
- An annual Borrowing Strategy;
- A Medium Term Investment Strategy 2013-2018 (approved June 2013); and
- A Medium Term Borrowing Policy & Strategy 2013-2018 (this document).

1.06 Members will receive a mid-year report and an annual report that will measure performance against the suite of agreed Treasury Management strategies.

The Case for Borrowing

Shetland Islands Council's "debt free" status

2.01 Shetland Islands Council has not had any external borrowing for 20 years. It has been the blanket policy of the Council to fund all capital expenditure from its reserves.

2.02 This position has been held on the incorrect understanding that funding from the Scottish Government would be reduced if Shetland Islands Council undertook any borrowing as the Council currently benefits financially from its debt free status. This benefit comes in the form of "Notional" Loan Charge Support which is an element of the Council's financial settlement from Scottish Government and is worth £12.255m in the 2013-14 financial year. All Councils that had outstanding borrowing at 31 March 2004 are supported by Scottish Government to service the debt (i.e. make the interest payments) because it was Scottish Ministers who granted borrowing consents to allow the local authorities to take on debt. Therefore the total Local Government settlement from the Scottish Government contains a ring-fenced element for Loan Charge Support which is worth several hundred million pounds per year.

2.03 As a result of Shetland Islands Council having no external borrowing at 31 March 2004, the Council would not have qualified to receive any of this ring-fenced funding. In order to address this inequality, it was agreed between the Council and Scottish Government that Shetland should receive "Notional" Loan Charge Support based on the average borrowing that Shetland would have had if it had borrowed like other local authorities. This has meant that instead of servicing debt with this funding, like all other local authorities do, Shetland Islands Council has been able to use this to support a higher level of services in the community.

2.04 However, as Scottish local authorities repay their pre-2004 debt, the value of the Loan Charge Support funding reduces and will eventually disappear. This will have no negative impact for those Councils because the funding matches their borrowing costs, so the funding stops when their debt has been repaid.

2.05 Shetland Islands Council is an exception – it will see a negative impact from reducing Notional Loan Charge Support because instead of servicing debt with this money, it has been used to fund services to the public.

2.06 Irrespective of whether the Council borrows externally or not in the future, the value of Notional Loan Charge Support will diminish each year until it finally runs out in the mid 2030s.

2.07 The table on the next page sets out the future annual values of Notional Loan Charge Support that will be included in Shetland Islands Council's settlement from Scottish Government:

Financial Year	Value of Notional Loan Charge Support £000s	In-year reduction in Loan Charge Support £000s
2008-09	£16,243	
2009-10	£15,706	-£537
2010-11	£15,294	-£411
2011-12	£13,524	-£1,770
2012-13	£12,994	-£530
2013-14	£12,255	-£739
2014-15	£11,498	-£757
2015-16	£11,094	-£404
2016-17	£10,245	-£849
2017-18	£9,398	-£847
2018-19	£8,753	-£645
2019-20	£8,240	-£513
2020-21	£7,765	-£474
2021-22	£7,162	-£603
2022-23	£5,943	-£1,219
2023-24	£5,666	-£278
2024-25	£5,037	-£628
2025-26	£4,663	-£374
2026-27	£4,226	-£437
2027-28	£2,703	-£1,524
2028-29	£2,186	-£517
2029-30	£1,984	-£201
2030-31	£1,694	-£290
2031-32	£660	-£1,034
2032-33	£621	-£40
2033-34	£403	-£218
2034-35	£220	-£183
2035-36	£67	-£153

Source: Scottish Government

2.08 What this table demonstrates is that the value of Shetland Islands Council's "debt free" status has already been set and will diminish each year until it finally runs out. This is because the Notional Loan Charge Support is based on pre-2004 borrowing levels and cannot be altered.

2.09 This means two things for the Council –

1. Shetland Islands Council faces a significant financial challenge to manage this decline in Scottish Government funding over the next 2 decades. To put it into context, Notional Loan Charge Support made up 14.3% of the Council's financial settlement from Holyrood in 2013-14. This means that the Council will need to see an above inflation increase of 14.3% (i.e. real terms increase) in its settlement from the Scottish Government by 2036 just in order to retain the same level of funding as the Council currently receives. However, based on the information available, the expectation is that the Council could potentially face a 10% real terms reduction in its settlement over the next 4 financial years. This means that at present, there is a real possibility that the Council will receive less funding from the Scottish Government in 20 years time than it currently does, despite inflation over that period.

2. Any external borrowing undertaken by the Council in the future will not have an adverse impact on the value of the Notional Loan Charge Support. This is because Notional Loan Charge Support was agreed at a fixed point in time based on historical data. The table above is not updated on an annual basis to reflect in-year transactions. Therefore, this is not a factor to consider when deciding whether the Council should borrow or not.

Is Shetland Islands Council really debt free?

2.10 Whilst Shetland Islands Council has no external debt, it does have internal borrowing. Therefore, the Council isn't actually debt free, it has just financed its debt using its own reserves. This is the reason why the Council's external investments and working capital have a lower value than the reserves in the balance sheet – it simply means the Council's reserves aren't fully cash backed because they've been used to meet the Council's Capital Financing Requirement (CFR).

2.11 The Capital Financing Requirement is the Council's underlying need to borrow to finance its capital expenditure. The Finance Service engaged a Treasury Management consultant to explore the benefits of borrowing and as part of that work they reconciled the Council's 31 March 2013 balance sheet to its Capital Financing Requirement.

Line	Description	2012-13 £m
A	Reserves & Balances (from balance sheet)	268.5
B	Working Capital and long term loans (from balance sheet)	(11.6)
C = A+B	**TOTAL AVAILABLE FUNDS in balance sheet**	**256.9**

	Supported by:	
D	Investments	205.7
E= C-D	Therefore, the amount of reserves not cash backed is:	51.2

Line	Description	2012-13 £m
A	Capital Financing Requirement (as above)	51.2
	Made up of:	
B	General Fund Internal Borrowing (Solan & Bonxie Tugs)	12.6
C	Housing Revenue Account internal Borrowing (Historic housing debt)	38.6
D= B+C	**Capital Financing Requirement**	**51.2**
E	Less: Current external borrowing	0
F=D-E	**Shetland Islands Council under-borrowed position**	**51.2**

2.12 What these tables essentially demonstrate is that the Council actually has £51.2m of debt, but at present it is all internal, which means that the organisation has an under-borrowed position of £51.2m. This means that if the Council decided to spend all of its reserves and balances tomorrow, it would need to borrow £51.2m to have the cash to do so.

Internal Borrowing versus External Borrowing

2.13 The economic case for borrowing externally or using the Council's own reserves to finance capital expenditure is essentially down to whether interest rates are higher or lower than the long term average return on the Council's external investments (with fund managers).

2.14 If interest rates are higher than the long term rolling average return on the Council's investments (currently 5.75%) then it means the cost of borrowing is higher than the lost income forgone by using reserves, so it would make financial sense to use reserves for capital expenditure.

2.15 For example, if interest rates were 10% for a £1m loan -

Annual interest payable on £1m at 10% = £100,000

Investment income of 5.75% generated on £1m = £57,500

In this example to borrow would cost £100,000 a year, and to use reserves would present an opportunity cost of £57,500 in lost investment income. In this example, using reserves would present a saving of £42,500 per year over using borrowing.

2.16 However, the reverse is true if interest rates are lower than the long term average return on the Council's investments (currently 5.75%). For example if interest rates were 2% for a £1m loan -

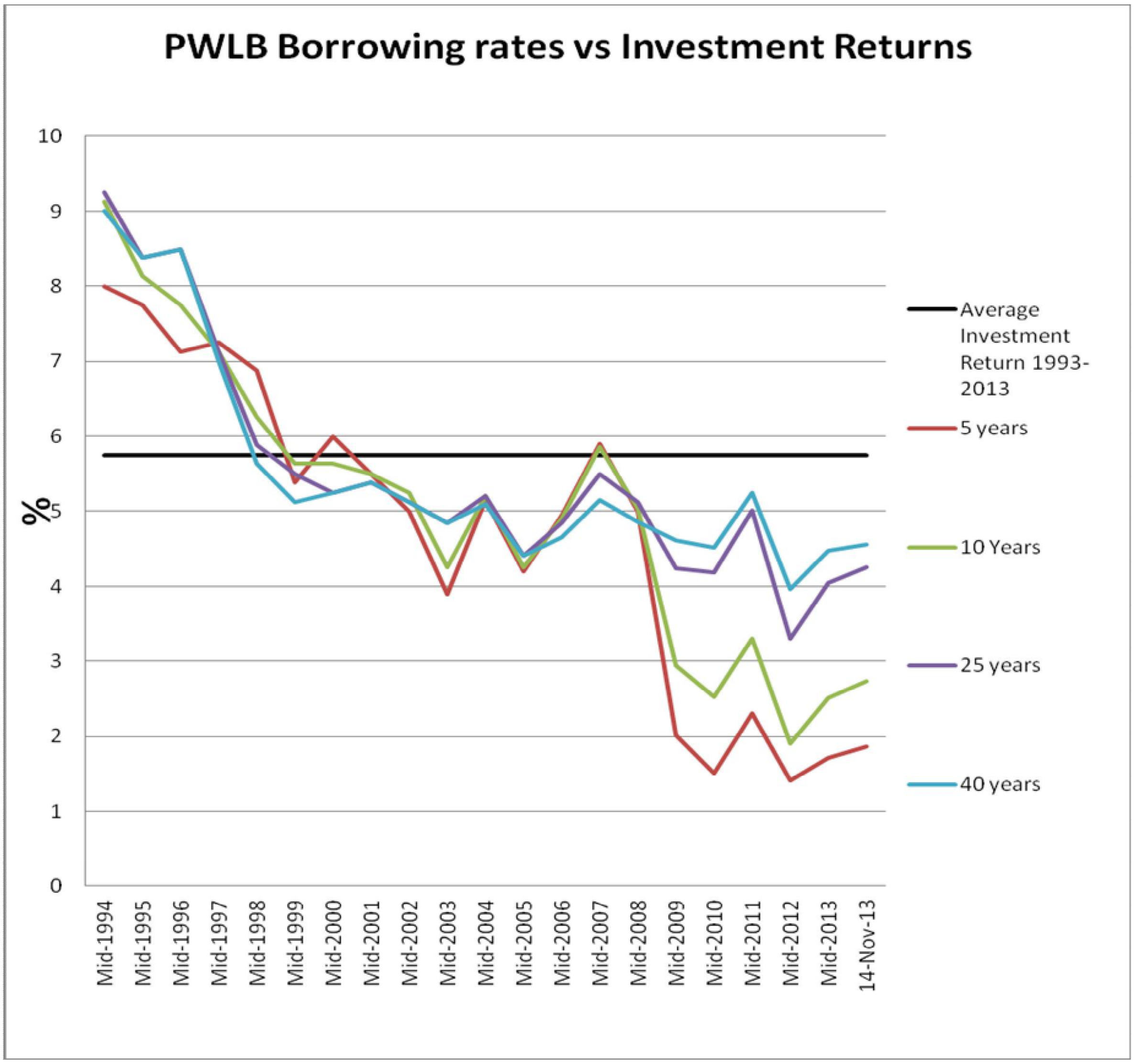
Annual interest payable on £1m at 10% = £20,000

Investment income of 5.75% generated on £1m = £57,500

In this example, to borrow would cost £20,000 a year and to use reserves would present an opportunity cost of £57,500 in lost investment income. In this example borrowing would save the Council £37,500 per year.

2.17 Therefore when interest rates are lower than long term investment returns, the default position of the Council should be to borrow in order to achieve a Best Value outcome.

2.18 The table below sets out actual historic interest rates for 5, 10, 25 and 40 year loans over the past 20 years against average investment returns of 5.75%:



2.19 What the graph shows is that interest rates for borrowing are currently significantly lower than the long term average return on external investments, and therefore at present it is in the Council's best economic interests to borrow externally rather than use reserves to fund capital expenditure.

2.20 Based on current interest rates it could be possible to externalise £50m of the Council's underlying need to borrow at a rate 2% lower than the average return on reserves. If this was achieved it would result in the Council benefiting by approximately £1m per year.

The Cost of Borrowing

2.21 Shetland Islands Council has been in the unique position of having significant reserves which in the past it has used to fund its capital expenditure. This has in effect meant that from a service perspective point of view, new assets have essentially been a "free good". When borrowing is used to finance capital expenditure, like with the Housing Revenue Account, the service is required to make provision for debt charges (principal debt repayment and interest costs) which is a significant difference to the current practice for General Fund capital expenditure where no service pays for its assets financing costs. This should be borne in mind when a decision to borrow is taken.

Conclusion

2.22 In order to secure Best Value in the financing of capital expenditure, the Council should use its statutory powers to consider borrowing as an option to do this. In order to regulate and monitor Council borrowing, the Council will need a borrowing policy and a set of prudential indicators to set the financial parameters for borrowing.

Shetland Islands Council Borrowing Policy

3.01 The Council's borrowing policy will be as follows:

- Borrowing should only be considered as a financing option when the interest rate obtainable is lower than the 20-year average return on the Council's external investments (i.e. Fund Manager returns);
- Borrowing will only be undertaken for capital projects, with a presumption against funding of short life assets (i.e. assets with less than a 5 year useful economic life);
- Borrowing should only be considered for priority capital projects that are supported by a full business case;
- Members must be fully advised of the ongoing revenue implications arising from each recommendation to borrow before a decision is taken by Council;
- If Members decide to borrow, they must also agree how the relevant Council directorate will be able to fund the borrowing costs (i.e. interest and principal repayments) within its existing Target Operating Budget as set out in the Medium Term Financial Plan;
- Borrowing can only be undertaken within the parameters of the Prudential Framework and the Prudential Indicators which will be agreed annually by Council;
- Borrowing may be undertaken up to 2 years in advance of its deployment to finance agreed capital expenditure if expectations on future versus current interest rates make it financially advantageous for the Council to do so;
- The Council will never borrow for the purposes of investing to make a profit;
- The Executive Manager – Finance as Section 95 Officer is the only officer of the Council who may recommend a decision to borrow to Council;
- When a decision to proceed to borrow has been taken by Council, the details of the loan(s) will be delegated to the Executive Manager – Finance who will determine the institution, the type, the timing, and the length of the loan after seeking advice from external Treasury Management specialists as to the most economically advantageous transaction;
- This Borrowing policy must be reviewed by Council within 6 months of a Local Authority election in Shetland.

The Prudential Framework & Prudential Indicators

Prudential Framework

4.01 The Local Government in Scotland Act 2003 repealed Section 94 of the Local Government (Scotland) Act 1973. Sections 35 to 37 of the 2003 Act introduced a responsibility for local authorities to locally determine the level of capital investment. Regulations introduced under the Act required that local authorities should adhere to The CIPFA Prudential Code for Capital Finance in Local Authorities.

4.02 The Prudential Code was introduced in April 2004, effectively replacing the Capital Expenditure controls within section 94 where ministerial consent was required before any capital expenditure could be incurred. In addition, there was a restriction on the commitment to capital expenditure for future years and a control over the actual financing of the capital expenditure. The 'prudential framework' (or prudential regime) is the collective term for legislation, regulation and the Code under which local authorities will operate.

4.03 The introduction of the Prudential Code brought much greater flexibility for Councils to develop capital programmes to support their local communities. The key watchwords within the Prudential Code are:-

- Affordability
- Prudence
- Sustainability

4.04 The Prudential Code provides a framework for the internal control and self-management of capital finance, and in turn the key items of expenditure that will normally govern the bulk of an authority's potential need to borrow. It does also refer in paragraph 3 to the fact that forward estimates of external debt, defined in part as actual external borrowing, will follow on from an authority's capital plans and revenue forecasts, under their treasury management strategy.

4.05 It is understandable that the Prudential Code seeks to concentrate primarily upon a need for an authority to ensure that its capital spending plans are affordable, as it is these plans that will, in general, be the main driver of an authority's need to undertake or increase the amount of external borrowing. The opening paragraph of the Executive Summary makes clear its overriding objective, namely "The Prudential Code plays a key role in capital finance in local authorities"; whilst paragraph 7 of its Objectives states that it focuses on capital finance and effective capital planning. The Prudential Code perhaps sums up the overall situation regarding the consideration of affordability in paragraph E12, wherein it states – "affordability is ultimately determined by a judgement about acceptable council tax levels".

4.06 The Council's capital expenditure plans are the key driver of treasury management activity. The outputs from the capital expenditure plans are reflected in Prudential Indicators, which are designed to assist Members overview and confirm capital expenditure plans.

4.07 In setting their prudential limits, Members must have regard to:

- Affordability, e.g. implications of capital plans for council tax and council housing rents.
- Prudence and sustainability, e.g. implications of external borrowing and an assessment of borrowing costs and interest rate forecasts/expectations.
- Value for money, e.g. options appraisal.
- Stewardship of assets, e.g. asset management planning.
- Service objectives, e.g. strategic planning for the authority.
- Practicality, e.g. achievability of the forward plan.

Prudential Indicators

4.08 It is proposed that the Prudential Indicator limits for Shetland Islands Council should be as follows:

1. Ratio of Financing Costs to Net Revenue Stream

Definition

General Fund – The proportion of the General Fund income from the Council's General Revenue Grant (including NNDR) and Council Tax income to fund the debt financing costs (interest and Principal Repayments) of the planned capital programme.

Housing Revenue Account – The proportion of income to the HRA (substantially Housing Rents) to fund the debt financing costs (interest and Principal Repayments) of the planned capital programme.

General Fund	2013-14 Estimate (%)	2014-15 Estimate (%)	2015-16 Indicative (%)	2016-17 Indicative (%)
Ratio of financing costs to net revenue stream	0.00	9.83	9.97	10.01

Housing Revenue Account	2013-14 Estimate (%)	2014-15 Estimate (%)	2015-16 Indicative (%)	2016-17 Indicative (%)
Ratio of financing costs to net rev stream	62.40	26.24	25.10	24.46

Harbour Account	2013-14 Estimate (%)	2014-15 Estimate (%)	2015-16 Indicative (%)	2016-17 Indicative (%)
Ratio of financing costs to net rev stream	9.63	9.73	9.53	6.91

2. Capital Expenditure

Definition
Estimated capital expenditure for the next 3 years' capital programme, as set out in the Council's Asset Investment Plan.

General Fund	2013-14 Estimate £000s	2014-15 Estimate £000s	2015-16 Indicative £000s	2016-17 Indicative £000s
Capital Expenditure	10,392	8,746	5,453	46,370

Housing Revenue Account	2013-14 Estimate £000s	2014-15 Estimate £000s	2015-16 Indicative £000s	2016-17 Indicative £000s
Capital Expenditure	3,109	1,700	1,100	1,100

Harbour Account	2013-14 Estimate £000s	2014-15 Estimate £000s	2015-16 Indicative £000s	2016-17 Indicative £000s
Capital Expenditure	1,143	140	140	140

3. Gross Borrowing and the Capital Financing Requirement

Definition
The CFR represents the underlying need to borrow for a capital purpose. As the Council should only borrow for a capital purpose, net external borrowing should not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years.

General Fund	2012-13 Actual £000s	2013-14 Estimate £000s	2014-15 Estimate £000s	2015-16 Indicative £000s	2016-17 Indicative £000s
Capital Financing Requirement	0	0	14,000	13,680	13,346
Gross Borrowing	0	0	14,000	13,680	13,346
Under/(Over) Against Latest CFR projection for year	0	0	0	0	0

Housing Revenue Account	2012-13 Actual £000s	2013-14 Estimate £000s	2014-15 Estimate £000s	2015-16 Indicative £000s	2016-17 Indicative £000s
Capital Financing Requirement	40,496	38,629	26,129	25,532	24,909
Gross Borrowing	0	0	26,129	25,532	24,909
Under/(Over) Against Latest CFR projection for year	40,496	38,629	0	0	0

Harbour Account	2012-13 Actual £000s	2013-14 Estimate £000s	2014-15 Estimate £000s	2015-16 Indicative £000s	2016-17 Indicative £000s
Capital Financing Requirement	12,618	12,267	11,497	10,726	9,956
Gross Borrowing	0	0	0	0	0
Under/(Over) Against Latest CFR projection for year	12,618	12,267	11,497	10,726	9,956

4. Authorised Limit for External Debt

Definition
Limit for total external debt that should not be breached. This excludes investments and is based on future capital plans and variations in cash flow.

General Fund	2012-13 Actual £000s	2013-14 Estimate £000s	2014-15 Estimate £000s	2015-16 Indicative £000s	2016-17 Indicative £000s
Borrowing	0	0	14,000	13,680	13,346
Long Term Liabilities	4,663	6,196	6,093	5,987	5,875
Total Authorised Limit	4,663	6,196	20,093	19,667	19,221

Housing Revenue Account	2012-13 Actual £000s	2013-14 Estimate £000s	2014-15 Estimate £000s	2015-16 Indicative £000s	2016-17 Indicative £000s
Borrowing	40,496	38,629	26,129	25,532	24,909
Long Term Liabilities	0	0	0	0	0
Total Authorised Limit	40,496	38,629	26,129	25,532	24,909

Harbour Account	2012-13 Actual £000s	2013-14 Estimate £000s	2014-15 Estimate £000s	2015-16 Indicative £000s	2016-17 Indicative £000s
Borrowing	12,618	12,267	11,497	10,726	9,956
Long Term Liabilities	0	0	0	0	0
Total Authorised Limit	12,618	12,267	11,497	10,726	9,956

5. Operational Boundary for External Debt

Definition
A boundary for total external debt based on the estimate of total projected external debt to be monitored against during the year. It may be breached temporarily for variations in cash flow but a sustained or regular breach would require investigation.

General Fund	2012-13 Actual £000s	2013-14 Estimate £000s	2014-15 Estimate £000s	2015-16 Indicative £000s	2016-17 Indicative £000s
Borrowing	0	0	14,000	13,680	13,346
Long Term Liabilities	4,663	6,196	6,093	5,987	5,875
Total Operational Boundary	4,663	6,196	20,093	19,667	19,221

Housing Revenue Account	2012-13 Actual £000s	2013-14 Estimate £000s	2014-15 Estimate £000s	2015-16 Indicative £000s	2016-17 Indicative £000s
Borrowing	40,496	38,629	26,129	25,532	24,909
Long Term Liabilities	0	0	0	0	0
Total Operational Boundary	40,496	38,629	26,129	25,532	24,909

Harbour Account	2012-13 Actual £000s	2013-14 Estimate £000s	2014-15 Estimate £000s	2015-16 Indicative £000s	2016-17 Indicative £000s
Borrowing	12,618	12,267	11,497	10,726	9,956
Long Term Liabilities	0	0	0	0	0
Total Operational Boundary	12,618	12,267	11,497	10,726	9,956

6. Actual External Debt at 31 March 2013

Definition
The actual external debt taken from the Balance Sheet as at 31st March 2013.

General Fund	2012-13 Actual £000s
Borrowing	0
Long Term Liabilities	4,663
Total External Debt	4,663

Housing Revenue Account	2012-13 Actual £000s
Borrowing	0
Long Term Liabilities	0
Total External Debt	0

Harbour Account	2012-13 Actual £000s
Borrowing	0
Long Term Liabilities	0
Total External Debt	0

7. Upper limit on Interest Rate Exposures

Definition
Ranges within which the Council will manage its exposures to fixed and variable rates of interest. Whilst the Council could obtain more favourable interest rates with a variable rate, it increases the longer term risk of rates rising beyond a fixed rate. It is calculated as a percentage of total net outstanding principal sums of debt.

	2013/14 Actual £'000	2014/15 Estimate £'000	2015/16 Indicative £'000	2016/17 Indicative £'000
Fixed interest rate exposures	N/A	100%	100%	100%
Variable interest rate exposures	N/A	40%	40%	40%

8. Maturity Structure of Borrowing

Definition
Upper and lower limits to assist the Council to avoid large concentrations of fixed rate debt that has the same maturity structure and would therefore need to be replaced at the same time. This is the fixed rate debt maturing in each period as a percentage of total projected borrowing that is fixed rate.

	Lower Limit	Upper Limit
Under 12 months	0%	25%
12 months and within 24 months	0%	30%
24 month and 5 years	0%	50%
5 year and within 10 years	0%	70%
10 years and above	0%	100%

Borrowing Strategy 2013-2018

5.01 The borrowing strategy is closely linked to the Council's Asset Investment Plan as borrowing can only be undertaken for capital projects. However, the Council also has some historic internal borrowing issues that require to be addressed.

5.02 The following borrowing strategy is therefore proposed over the course of the Medium Term Financial Plan 2013-2018.

General Fund

5.03 The proposed Asset Investment Plan 2014-2019 has a strong focus on the maintenance of existing assets as opposed to the creation of new or replacement assets. This has been proposed to fit within the parameters set in the Council's Medium Term Financial Plan, which has an overall objective of bringing the Council's level of spending back in line with the resources that are available to it each year. What this has meant is that the Asset Investment Plan is fully funded through the Capital Grant from Scottish Government, and capital receipts from the sale of surplus assets. The one exception to this is the one third contribution that the Council is required to make for the new Anderson High School.

5.04 It is proposed that the Council undertakes external borrowing to finance its one-third share of the Anderson High School project. The borrowing will be drawn down at a time that is most economically advantageous to the Council.

5.05 At present, there are no unfunded projects in the Asset Investment Plan and therefore no requirement to borrow for any other projects. However, if actual capital grants from Scottish Government are lower than anticipated or capital receipts fall short of estimations, borrowing could be considered to meet any capital financing requirement in future.

5.06 It is recognised that Shetland's infrastructure is aging and significant capital investment will be required in the longer term beyond the period covered by the current Medium Term Financial Plan. It is for this reason that work will begin early in 2014 to create a 30 year long term financial plan that will focus on the capital investment required in future and how this can be achieved affordably, prudently and sustainably.

Housing Revenue Account

5.07 Due to the size of the existing housing debt, the Medium Term Financial Plan has set a policy decision that means the Housing Revenue Account (HRA) cannot undertake any additional borrowing whilst the level of debt is unsustainably high. As a result the Asset Investment Plan restricts the level of capital expenditure on the HRA so that it can be fully funded without the requirement to borrow. This means that the borrowing strategy for the HRA over the period 2013-2018 is not to undertake any new borrowing during this period.

5.08 However, the issue still remains over the existing level of debt which is currently being managed internally. With interest rates at their current levels, it is not possible to achieve a Best Value outcome for the Council by continuing to finance the housing debt through internal borrowing.

5.09 Up to and including 2012-13, the Council was managing down debt costs for the HRA by providing it with a preferential interest rate which kept the interest costs low. However, this was at a direct cost to the General Fund which was lending money at c.1% instead of investing the money with fund managers that average a 5.75% return per year. The table below sets out how this situation impacted upon each fund:

Based on £40m of Housing Debt	HRA	General Fund
(Income)/Expenditure at 1% interest rate	£800,000	(£800,000)
(Income)/Expenditure at 5.75% interest rate	£2,300,000	(£2,300,000)
Net position for the HRA and the General Fund	GF subsidy of £1.5m	Lost income of £1.5m

5.10 What this table shows is that the General Fund was losing an average of £1.5m per year in lost income, which could have been used to fund council services.

5.11 Clearly this was not a Best Value outcome for the General Fund, and therefore in the 2013-14 budget, the HRA was required to pay interest of 5.75% which is equal to what the General Fund could achieve on external markets. The table below sets out how this situation impacted upon each fund:

Based on £40m of Housing Debt	HRA	General Fund
(Income)/Expenditure at 5.75% interest rate	£2,300,000	(£2,300,000)
Borrowing from PWLB at 4.5%	£1,800,000	N/A
Net position for the HRA and the General Fund	HRA paid £500,000 more in interest that it would if debt was external.	Achieved the same level of income as external investment

5.12 What the table shows is that whilst the General Fund received the level of return equal to external investment, the HRA endured borrowing costs that were £500,000 more than if the debt had been externalised.

5.13 In order to secure a Best Value outcome for both the HRA and the General Fund, it is proposed to externalise all housing debt (net of any write off).

Harbour Account

5.14 All Harbour Account capital expenditure over the next 5 years (as set out in the Asset Investment Plan) will be funded from the Harbour Account revenue budget (CFCR). It is therefore proposed that there will be no new borrowing on the Harbour Account during this period of time.

5.15 The Harbour Account currently has approximately £14m of internal borrowing which had been undertaken for the new Tugs. It would be economically advantageous to externalise this debt and therefore this will be the position should the Harbour Account confirm that the Tugs will be retained. At present, no action will be taken to externalise this debt as there is an expectation that these Tugs will be sold.

Borrowing Strategy Conclusion

5.16 The Borrowing Strategy set out here will be undertaken within the parameters of both the Borrowing Policy as set out at Section 3.1 and the Prudential Indicators as set out in Section 4.8.