| Title | Derby City Council Protocol for HRA Debt Finance under HRA Reform |
|---|---|
| **Date** | **2/12/2011** |
| **Version** | **6** |

**Split of existing debt**

1. All Derby City Council debt will remain substantially as a single pot, managed by the Council. However, for the purposes of debt management post-reform the Council's debt will be split notionally between the General Fund and the HRA, with the General Fund as lender and the HRA as borrower. The HRA will then service its notional debt portfolio, making decisions about take-up of new debt and redemption of existing debt with regard to the long term financial position of the HRA, and making any principal and interest repayments to the General Fund.

2 The only exception applying to the ability of the HRA to make financing decisions concerns the treatment of the existing LOBO loans and transferred debt as at 31 March 2012(see below).

3. The notional splits will take place as follows:

**4. PWLB debt** – The announcement in September 2011 of a special PWLB loans facility to be made available to authorities undergoing HRA Reform has required the Council to adopt a specific approach to the split of all PWLB debt as at 31 March 2012 in order to ensure that both the General Fund and the HRA commence business on 1 April 2012 with closely matched if not equal average interest rates on their debt portfolios. This process cannot be finalised until after 31 March 2012, when the final external debt position of the Council will be known.

5. The value of the special PWLB loans facility to be made available to Derby City Council HRA is £29,492,000 and this will be offered at approximately 85 basis points below the rate offered to councils generally. This loan is expected to be taken in March 2012. To counteract the unequal impact of this loan on both the General Fund and the HRA it is proposed to split the remaining PWLB loans in such a way as to ensure equal initial average interest rates for both the HRA and General Fund. In practice, this will mean allocating some higher-rated historic loans to the HRA – known as balancing debts and which will be allocated wholly to the HRA, some lower-rated loans wholly to the General Fund, and splitting the remaining loans in proportion to the outturn Capital Financing Requirements of the General Fund and HRA as at 31 March 2012, according to the final percentage applicable as calculated below.

6. For the purposes of this calculation, the General Fund Capital Financing Requirement (CFR) will exclude the value of any liability associated

with PFI contracts, and the HRA CFR will exclude the value of the special loans facility. These loans will also be excluded from any loans pool that is to be split in accordance with CFR shares.

7. Each loan within the HRA portfolio will be notional, regardless of whether it is a specially allocated loan or whether it is a 'split' loan. The terms of each notional loan within the HRA portfolio will remain the same as the substantial loan from which it has been derived. As at 31 March 2011 the total of PWLB loans held by the Council was £245,295,383, and a further £93,000,000 of borrowing is currently planned for 2011/12 (excluding the planned £29.5m HRA buy-out loan).

8. For information the forecast Capital Financing Requirements for the General Fund (excluding PFI) and the HRA as at 31 March 2012 (excluding the buy-out amount but including a further £12.573m of routine HRA borrowing before the end of March 2012) are as follows:

| | CFR | Proportion |
|---|---|---|
| General Fund | £248,823,459 | 55.08% |
| HRA | £202,902,996 | **44.92%** |
| Total | £451,726,454 | 100.00% |

9. This means that the HRA will take on approximately £152m of notional PWLB debt on 1 April 2012 (subject to refinement at accounts closure). The final calculation of the actual figure at the end of the 2011/12 financial year will result in a percentage (44.92% in the estimate above) for the HRA of 'old' – that is pre 2012/13 debts , and this percentage will remain fixed with respect to such debts thereafter.

**10. LOBO debt** – The Council's two £10m LOBO loans from Royal Bank of Scotland will each be split in line with the HRA's and the General Fund's CFRs, and the HRA element (approx 45%) will be added to the HRA's notional debt portfolio. If RBS chooses to increase the interest rate on either of these loans – thereby effectively calling the loan - then the Council will make the decision as to whether the loan should be redeemed or the new interest rate accepted. At this point the terms of the corresponding notional HRA LOBO will be altered accordingly.

For information, the relevant rates are shown in the table below:

| Loan Ref | Principal | Settlement Date | First Call Date | Initial Rate |
|---|---|---|---|---|
| 760998 | £10m | 8-11-2010 | 8-11-2015 | 4.17% |
| 760845 | £10m | 28-2-2011 | 28-2-2016 | 4.10% |

**11. Transferred Debt** – There are two transferred debts held by the Council – one from the County Council relating to non housing services - as at 31 March 2012 this is estimated to be £36,489,221. This is repayable on a 4% reducing balance basis and principal, interest and expenses payments could be split in proportion the Capital Financing Requirements of the Council's

General Fund and HRA as at 31 March 2012, giving an estimated HRA share of £16,390,958 (44.92%). Interest on transferred debt is determined by Derbyshire County Council and cannot be fixed in advance.
The second transferred debt includes a specifically HRA element of transferred debt from Erewash District Council, estimated to be £738,038 as at 31 March 2012, out of a total of £747,000 outstanding. This could also be split according to the CFR shares for consistency with the County Council debt treatment.

An alternative treatment for both transferred debts would be to split them according to their origin which would mean that the HRA would pick up only the element of Erewash debt that relates to housing. As a result, the HRA would then need to pick up other debts to make up the total. This decision is yet to be made by the Council but will be included in the final version of this protocol.

For illustrative purposes, both debts have been split at this stage.

**Summary** – Based on the above outline, the HRA loans portfolio as at 1 April 2012 is forecast to be approximately as follows:

| **Loan type** | **Derived from** | **Amount (£m)** |
|---|---|---:|
| Notional PWLB | PWLB | 152.0 |
| Self-Financing Loan | PWLB | 29.5 |
| Notional LOBO | RBS | 9.0 |
| Transferred Debt | County/Erewash | 16.7 |
| Total | | 207.2 |

**Under-borrowing** – Under the current item 8 regulation, HRA 'under-borrowing' is charged to the HRA by the General Fund at the average 3-month LIBID rate for the year. This represents a loan from the General Fund to the HRA, at a rate equal to the interest foregone by the General Fund from having used its cash balances to temporarily postpone the HRA's need to borrow. In principle, therefore, *the HRA is never under-borrowed*: it has a mixed portfolio of loans – consisting of relatively expensive PWLB loans and relatively cheap General Fund loans – that always equals its Capital Financing Requirement.

In line with Council policy, HRA variable borrowing will be restricted to 20% of the HRA CFR. Any under-borrowing will be treated as variable rate borrowing and therefore count against this limit.

This notional short term -loan from the General Fund to the HRA is managed retro-actively: its size cannot be calculated until after the CFR has been finalised for the year; and the interest rate applicable cannot be calculated until after the year-end (and an average rate calculated).

The average size of the short term loan for any financial year will be defined as follows:

CFR as at 31 March less any notional loans (listed in Summary above) held by HRA as at 31 March
plus
CFR as at 1 April the previous calendar year less any notional loans held by HRA as at 1 April the previous calendar year
all divided by 2

Under HRA reform the same calculation will apply, the rate used being the average 6-month variable rate as published by the PWLB. This is currently 1.6%. A fee will apply to this loan and will be calculated in line with PWLB fees for variable-rate loans.

**Take-up of new debt**

The HRA will be free to take up new debt in line with its business requirements. Loans will be offered to it by the Council's General Fund on the same basis that loans are offered to the Council by PWLB. Market-style loans will also be made available to the HRA on the same basis that they are offered to the Council as a whole. The HRA will take no loans (including finance leases) from any other party than the Council's General Fund.

Once the terms of any individual loan are agreed between the HRA and the General Fund these will be unchangeable.

The fees that will apply to PWLB loans taken by the HRA are as follows:
Fixed rate loans - 35p for every £1,000 or part of £1,000
Variable rate loans - 45p for every £1,000 or part of £1,000
Minimum fee - £25
These fees match current PWLB fees and will be updated in line with PWLB fees.

Fees for market-style loans will reflect those offered at the time. Complicated loans may attract an additional admin fee levied by the General Fund, reflecting the additional work undertaken in arranging the loan on behalf of the HRA.

**Early Redemption of debt**

The HRA will be able to redeem any loan in its portfolio that has been offered to it on PWLB terms. Any charge on redemption (ie. a premium or discount) will be calculated using the PWLB discounted cashflow method using the redemption rates as published on the day.

Market-style loans can be redeemed by the HRA under the same terms offered by the market lender.

**Interest on Balances**

The HRA currently receives interest on the average value of its reserves, at a rate equal to the average 7-day LIBID for the financial year. It is not intended to make any change to this policy

**Premiums and Discounts**

At 1 April 2012 the HRA will have £1,304,308.54 of net discount (arising from previous debt redemption exercises) held on the Balance Sheet. Subject to (a) clarification from the Council's treasury management advisors and (b) any specific regulations pertaining to premiums and discounts under Item 8, it is proposed to write this net discount off to general HRA balances during 2012/13.

A similar write-off will be undertaken for General Fund premiums and discounts.

**Charging Protocol**

Financing charges made to the HRA will be made as part of the accounts closure process at year-end, via journal transfer. The charges will cover notional loan fees and interest only. Principal amounts will not require journal transactions.

**Future changes to protocol**

It is intended that this be protocol be ratified at full Council, and that future changes to the protocol be made only with full Council approval. It is not intended that such changes would be necessary unless there are external factors involved – for example a change in legislation or to debt controls on local authorities that require such change.

**Roger Kershaw**
**Strategic Director of Finance**

**Date Ratified by Council**

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