

MRWA REPORTCASH POSITION & OPTIONS MOVING FORWARDCurrent position

Merseyside Recycling and Waste Authority (MRWA) is currently running an overdraft of circa £18million. This overdraft has fluctuated during the year to date and has stood at between £14million and £20million and it is currently estimated that the overdraft position at the year end will be £16million. There is a cost to having an overdraft, due to the interest that is charged against the overdrawn balance, and the purpose of this report is to consider options available to MRWA to minimise costs in relation to the overdraft and, potentially, look at ensuring this cost is a fixed cost moving forward.

MRWA is overdrawn is due to the budget setting process that has been followed over a number years, whereby it has been approved that the budget would be set so as to minimise charges to member authorities by utilising balances that have been built up previously. The total reserves of the Authority have reduced from £22.434million at the end of 2013/14 to £3.404million as at 31<sup>st</sup> March 2018.

At the same time as following a budget setting process whereby reserves are utilised to assist in keeping increases in levy to a minimum, the Authority has been incurring capital expenditure which had approval to be funded via borrowing. However, although borrowing may have been the approved method of financing capital spend for certain schemes, each year the most cost efficient way of funding capital expenditure will be assessed to ensure the Authority is getting best value for money. Interest rates have hit historic lows, meaning that, although the rate to borrow has been low, it has been cheaper to utilise cash balances to fund expenditure, as cash balances that are retained and invested return an even lower rate of interest. This is known as internal borrowing.

This position is confirmed in the latest audited statement of accounts

(<http://www.merseysidewda.gov.uk/wp-content/uploads/2018/08/Statement-of-Accounts-Final-30.07.18.pdf>) :

|                                | £ m      |                  |
|--------------------------------|----------|------------------|
| Capital Financing Requirement* | 46.596   | Note 25, page 54 |
| Long Term Borrowing            | (16.830) | Note 11, page 43 |
| Under-borrowed                 | 29.766   |                  |

The Authority has the power to borrow in accordance with the Local Government Act 2003 and following guidance within CIPFA's *Prudential Code for Capital Finance in Local Authorities*.

\* The Capital Financing Requirement is the Authority's underlying need to borrow.

## Current overdraft

MRWA does not have a bank account and the cash of the Authority is held by St Helens Council who also, currently, provide the overdraft facility. The management of cash is undertaken in accordance with a Service Level Agreement (SLA) and, under the terms of the SLA, the charge for cash overdrawn is the Bank Rate plus 2%. The Bank Rate is set by the Bank of England and has been at an historically low rate of 0.25% for a period of time. However, following interest rate rises in November 2017 and August 2018, the rate now stands at 0.75% with the Governor of the Bank of England, Mark Carney, stating that there would be further “gradual” rate rises to come. Below is the forecast, as at September 2018, for how Bank Rate may change over time from Link Asset Services and Capital Economics:

|                     | Q3 18 | Q4 18 | Q1 19 | Q2 19 | Q3 19 | Q4 19 | Q1 20 | Q2 20 | Q3 20 |
|---------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| Link Asset Services | 0.75% | 0.75% | 0.75% | 0.75% | 1.00% | 1.00% | 1.00% | 1.25% | 1.25% |
| Capital Economics   | 0.75% | 0.75% | 0.75% | 1.00% | 1.25% | 1.25% | 1.25% | 1.25% | 1.25% |

There is currently great difficulty in forecasting movements in Bank Rate because movements are a reaction to local, and global, economic conditions but are currently also being influenced by uncertainty around Brexit negotiations.

## Options

### Option 1 – Continue with Overdraft Arrangement

The Authority could continue with the current arrangement with St Helens and continue to run an overdraft position. However, this is dependent upon St Helens continuing to agree to the arrangement and could see them either remove the facility or increase the interest rate that is charged. Continuing with this arrangement will also leave the Authority open to uncertainty around future movements in Bank Rate; this uncertainty could lead to future increase in interest costs and will make budgeting for this cost difficult.

### Option 2 – Borrow from PWLB

Local Authorities and other bodies such as Waste Authorities, have the powers to borrow money from the Public Works Loan Board (UK Treasury) at rates which are seen as attractive relative to market lending rates. In addition, Authorities can apply for the “Certainty Rate” which enables those bodies to access rates that are 0.2% below the quoted rates. MRWA has access to the PWLB Certainty Rate and so could borrow money, against the historical unfinanced capital expenditure (internal borrowing) at low rates. The current rates (as at 22<sup>nd</sup> October 2018) available from the PWLB, with the Certainty Rate reduction, are below:

| Length   | Interest Rate |
|----------|---------------|
| 1 Year   | 1.53%         |
| 5 Years  | 1.90%         |
| 10 Years | 2.32%         |
| 20 Years | 2.74%         |
| 40 Years | 2.67%         |
| 50 Years | 2.64%         |

These rates are very low and, like Bank Rate are forecast to increase over time. The table below shows the forecast for movements in interest rates moving forward.

| %         | Q4<br>18 | Q1<br>19 | Q2<br>19 | Q3<br>19 | Q4<br>19 | Q1<br>20 | Q2<br>20 | Q3<br>20 | Q4<br>20 |
|-----------|----------|----------|----------|----------|----------|----------|----------|----------|----------|
| 5yr PWLB  | 2.00     | 2.10     | 2.20     | 2.20     | 2.30     | 2.30     | 2.40     | 2.50     | 2.50     |
| 10yr PWLB | 2.50     | 2.50     | 2.60     | 2.70     | 2.70     | 2.80     | 2.90     | 2.90     | 3.00     |
| 25yr PWLB | 2.90     | 3.00     | 3.10     | 3.10     | 3.20     | 3.30     | 3.30     | 3.40     | 3.50     |
| 50yr PWLB | 2.70     | 2.80     | 2.90     | 2.90     | 3.00     | 3.10     | 3.10     | 3.20     | 3.30     |

A comparison of the interest costs under both options are included at Appendix A. As an example, borrowing from PWLB, over 10 years, would result in a reduced cost to the Authority of £77,400 per annum compared to the costs that St Helens would charge under the current arrangement, which equates to a saving of £774,000 over the lifetime of the borrowing.

### **Recommendation**

The underlying borrowing requirement (CFR) needs to be reviewed with MRWA to look at the forecast requirement and, indeed, the continuing use of reserves (cash requirement). This would be part of addressing the current internal borrowing and the overall requirement. This is critical to ensure that MRWA do not end up in a position of going from a large internal borrowing position to being overborrowed. It is therefore recommended that this exercise is undertaken as soon as possible to enable a borrowing strategy to be agreed. Once this has been addressed borrowing can be undertaken from PWLB (for appropriate periods) to eliminate the overdraft that the Authority has with St Helens and to build up a small amount of cash reserves for future flexibility.

By accessing the Certainty Rate, borrowing costs with PWLB should be lower or equivalent to the costs that St Helens are currently charging, whilst locking in certainty about future payment rates. This is viewed as desirable compared to the uncertainty that exists with the charges from St Helens due to forecast increases in Bank Rate and potential increases, plus borrowing now will access current PWLB Rates before forecast increases.

Provision for the cost of borrowing is currently being built up through Revenue Provision charges that are being made in accordance with the Annual Revenue Provision Policy Statement which is included within the Treasury Management Strategy Statement. The initial borrowing of the loan would change the underlying reserves position of the Authority, with the increase in cash being offset by a charge to the balance sheet for Long Term Borrowing.