



Report to: Cabinet

Subject: Prudential Code Indicators 2011/12 to 2013/14

Date: 13 January 2011

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PURPOSE OF REPORT

The report seeks formal approval of the Prudential and Treasury Indicators for Gedling Borough Council, for the financial years 2011/12 to 2013/14. Such approval is required to be given by the body responsible for setting the budget, however Cabinet are asked to review the proposed indicators, and then to submit them to full Council for approval.

BACKGROUND

The Local Government Act 2003 introduced the Prudential Framework for Local Authority Capital Investment. The key objectives of the Prudential Code are:

- To ensure that the capital investment plans of local authorities are affordable, prudent and sustainable.
- To ensure that treasury management decisions are taken in accordance with good professional practice
- To ensure that local strategic planning, asset management and proper option appraisal are supported

To demonstrate that these objectives have been fulfilled, the Prudential Code details the indicators that must be set and monitored. It does not suggest indicative limits or ratios, as these are for the local authority to set itself. The indicators are designed to support and record local decision-making, and not to be comparative performance indicators. The indicators cannot be set, or revised, in isolation from each other, but should be considered together.

In practice, the Code demands an iterative process, whereby the authority considers alternative financial strategies, before deciding on one that is suitably affordable, prudent and sustainable. The authoritative setting and revising of prudential indicators must, however, be carried out by the same body that takes decisions on the local authority budget, ie. Full Council.

The Prudential Code places significant responsibilities on chief finance officers in local government. Through the Code, the chief financial officer is responsible for ensuring that all matters required to be taken into account are reported to the decision making body for consideration. In considering its programme for capital investment, the Council is required within the Prudential Code to have regard to:

- Affordability, eg. the implications for Council Tax
- Prudence and sustainability, eg. the implications for external borrowing
- Value for money, eg. option appraisal
- Stewardship of assets, eg. asset management planning
- Service Objectives, eg. strategic planning for the authority
- Practicality, eg. the achievability of the forward plan

In all cases it will be for elected members to make the judgement between the constraints of affordability, and the demands of services for capital investment.

PROPOSAL

Appendix 1 details the proposed Prudential and Treasury Indicators for 2011/12 to 2013/14, and these are judged to meet the objectives of the Prudential Code. They represent capital investment plans that are affordable, prudent and sustainable.

Prudential Indicators

The five “Prudential” indicators deal with the affordability of the authority’s capital plans, with particular regard to the impact on the Council Tax. The Council’s detailed draft capital plans are included in the Draft Budget and Service Plan report which is an item included elsewhere on this agenda. In considering the affordability of such plans, the authority is required to consider all of the resources currently available and those estimated for the future, together with the totality of capital plans, revenue income and expenditure forecasts for three years. The Prudential indicators are based on expected outcomes.

It should be noted that a significant scheme included in the proposed capital programme is a replacement leisure facility which will facilitate the wider development of Arnold Town Centre. The initial business case for a replacement leisure facility has been assessed as affordable, and is mainly funded from grant, sale of assets, existing running costs, and savings in the longer term investment that would be required in existing facilities if they continued unchanged. The impact of this scheme is included within the Prudential Indicators below.

a) Ratio of Financing Costs to Net Revenue Stream

This represents estimates of financing costs, including current commitments plus the effect of medium term plan projections, in respect of the cost of borrowing.

Appendix 1 shows that the indicator is expected to be: 5.65% in 2011/12, 6.64% in 2012/13 and 10.55% in 2013/14.

b) Capital Expenditure

This indicator estimates the future capital plans of the authority. Appendix 1 shows that General Fund capital expenditure is expected to be £2,676,900 in 2011/12, £7,532,000 in 2012/13 and £5,085,000 in 2013/14.

c) Capital Financing Requirement

The Capital Financing Requirement (CFR) measures the authority's underlying need to borrow for capital purposes.

The Authority has an integrated Treasury Management Strategy, and adopted the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised November 2009) on 3 March 2010.

The Council has, at any point in time, a number of cashflows, both positive and negative, and manages its treasury position in terms of its borrowings and investments in accordance with its approved treasury management strategy and practices. In day-to-day cash management, no distinction can be made between revenue cash and capital cash. External borrowing arises as a consequence of all the financial transactions of the authority, and not simply those arising from capital spending. In contrast, the CFR reflects the authority's underlying need to borrow for capital purposes. The Capital Financing Requirement will increase whenever capital expenditure is incurred, but where such expenditure is resourced immediately (from capital receipts, direct revenue financing etc) the CFR will reduce at the same time, resulting in no net increase.

Appendix 1 shows that the Council's closing CFR is expected to be £11,303,162 in 2011/12, £17,846,939 in 2012/13 and £20,484,329 in 2013/14.

d) Net Borrowing and CFR

The Prudential Code includes the following as a key indicator of prudence:

"In order to ensure that over the medium term net borrowing will only be for a capital purpose, the local authority should ensure that net external borrowing does not, except in the short term, exceed the total of the Capital Financing Requirement in the preceding year plus the estimates of any additional Capital Financing Requirement for the current and next two financial years"

Appendix 1 shows that this indicator is expected to be £20,484,329 for 2011/12, £20,673,877 for 2012/13 and £20,735,809 for 2013/14, and the Head of Corporate Services confirms that no difficulties are envisaged for the current or future years. This view takes into account current commitments, existing plans, and medium term plan projections.

e) Incremental Impact of Capital Investment Decisions on Council Tax

This is a key measure of affordability which estimates the incremental impact on Council Tax of the capital investment decisions contained within the Medium Term Financial Plan, over and above capital investment decisions

that have previously been taken by the Council. The Council could consider different options for its capital investment programme in relation to their differential impact on the Council Tax.

Appendix 1 shows that the impact on Council Tax of new 2011/12 investment decisions is estimated to be a cost to the taxpayer of £0.41 per band D property in 2011/12, £3.25 in 2012/13 and £3.24 in 2013/14.

Treasury Indicators

The six “Treasury” indicators are based on limits, beyond which activities should not pass without management action.

a) Authorised Limit for external Debt

In respect of its external debt, the Council must approve an “Authorised Limit” for its total external debt, gross of investments, for each of the next three financial years.

These limits separately identify borrowing and other long-term liabilities such as finance leases. The Head of Corporate Services has delegated authority to effect movement between the separately agreed limits for borrowing and other long-term liabilities, within the total limit for any individual year, in accordance with option appraisal and best value for money for the authority. Any such changes made will be reported to the Council at its next meeting following the change.

Appendix 1 shows that this indicator is expected to be £22,500,000 for 2011/12, and £22,700,000 for both 2012/13 and 2013/14, in respect of borrowing, and £1,500,000 for each of the three years in respect of long-term liabilities. Accordingly, the total Authorised Limit for external debt is £24,000,000 for 2011/12, and £24,200,000 for both 2012/13 and 2013/14.

The Head of Corporate Services is satisfied that these Authorised Limits are consistent with the authority’s current commitments, existing plans and the proposals in this budget report for capital expenditure and financing, and with its approved treasury management policy statement and practices. The Head of Corporate Services confirms that they are based on the estimate of the most likely, prudent but not worst-case scenario with, in addition, sufficient headroom over and above this to allow for operational management, for example unusual cash movements. Risk analysis and risk management strategies have been taken into account, as have plans for capital expenditure, estimates of the Capital Financing Requirement and estimates of cashflow requirements for all purposes.

In taking its decisions on this budget report, the Council is asked to note that the Authorised Limit determined for 2011/12 will be the statutory limit determined under section 3(1) of the Local Government Act 2003.

b) Operational Boundary for External Debt

The Council must also approve an “Operational Boundary for external debt” for the next three financial years. The proposed Operational Boundary for external debt is based on the same estimates as the Authorised Limit, but reflects directly the Head of Corporate Services’ estimate of the most likely, prudent but not worst case scenario, without the additional headroom included within the Authorised Limit, and equates to the maximum external debt projected by this estimate.

The Operational Boundary represents a key management tool for in-year monitoring. Within this Operational Boundary, figures for borrowing and other long-term liabilities are separately identified. The Head of Corporate Services has delegated authority to effect movement between the separately agreed figures for borrowing and long-term liabilities, within the total Operational Boundary for any individual year, in a similar fashion to the Authorised Limit. Any such changes will be reported to the Council at its next meeting following the change.

Appendix 1 shows that this indicator is expected to be £21,500,000 for 2011/12 and £21,700,000 for both 2012/13 and 2013/14 in respect of borrowing, and £1,500,000 for each of the three years in respect of long-term liabilities. Accordingly, the total Operational Boundary for external debt is £23,000,000 for 2011/12, and £23,200,000 for both 2012/13 and 2013/14.

c) Upper limit for fixed rate interest exposure

d) Upper limit for variable rate interest exposure

The Upper limits for interest rate exposures are set to accommodate a Treasury Management Strategy in which fixed rate borrowing and investments are used to reduce uncertainty surrounding future interest rate scenarios, whilst retaining flexibility to achieve optimum performance through the use of variable interest rates. Indicators are represented by the maximum permitted **net outstanding principal sums borrowed** at fixed and variable rates, ie. the net position taking account of both borrowing and investment.

Appendix 1 shows that the indicator for the upper limit for borrowing and lending at fixed rates is to be set at £20,500,000 for 2011/12 and £20,700,000 for both 2012/13 and 2013/14. This allows for the scenario whereby maximum borrowing in advance of need is undertaken at fixed rates, should they be favourable. It also allows for a mix of long term and temporary cashflow borrowing at fixed rates, at any one time during the year.

The upper limit for variable rates is to be set at £2,000,000. This has been set at a much lower level in order to reflect the Council’s policy to borrow on fixed rates, whilst retaining a small amount of flexibility to borrow at variable rates if specifically required. In practice the Council will usually only invest at variable rates, therefore the daily position in respect of this indicator will generally be negative.

Appendix 1 also shows separate local indicators for upper limits on fixed and variable rates for borrowing and lending, since these are likely to be more meaningful to Members than the indicators set for the theoretical net position.

e) Upper limits for the maturity structure of borrowing

Upper limits for the maturity structure of borrowing are intended to avoid large concentrations of fixed rate debt having the same maturity structure, and therefore needing to be replaced at the same time. Such limits seek to avoid any substantial refinancing risks. It should be noted that the Council takes advice from its Treasury consultants, Sector, when determining its maturity profile, and if appropriate, debt rescheduling is undertaken to take full advantage of favourable interest rates.

Appendix 1 shows that this indicator is set at an upper limit of 20% for maturities under 1 year, 25% for those between 1 and 2 years, and 40% for those between 2 and 5 years. The limit is set at 50% for maturities between 5 and 10 years, and at 100% for maturities exceeding 10 years. These limits allow the flexibility to take full advantage of any particularly low rates for both medium and longer dated loans, should they become available.

f) Upper limits for principal sums invested for periods over 364 days

The upper limit for principal sums invested for periods in excess of 364 days is set to minimise the exposure to the possibility of loss that might arise as a result of having to realise an investment before it reaches its final maturity.

Whilst it is not anticipated that funds will be available for significant investment beyond 364 days during 2011/12, the Council's forward capital programme reflects an underlying need to borrow, and in the event that market rates are favourable, borrowing in advance of need may be prudent, as has been the case in previous years. This in turn may require flexibility in the use of investment periods in excess of 364 days in order to minimise the cost of carrying the advance borrowing.

Appendix 1 shows that this indicator is to be set at £5,000,000 for sums maturing beyond 31 March 2012 and £3,000,000 for sums maturing beyond 31 March 2013. No investment maturing beyond 31 March 2014 is currently envisaged.

RECOMMENDATION

Members are recommended to note the Prudential and Treasury Indicators for 2011/12 to 2013/14 as detailed in Appendix 1, which have been set with due reference to CIPFA's Prudential Code, under the Local Government Act 2003, and to refer them to Full Council for approval.

APPENDIX 1

Prudential and Treasury Indicators for 2011/12 to 2013/14

Prudential Indicators

	2009/10 Actual	2010/11 Original Estimate	2011/12 Estimate	2012/13 Estimate	2013/14 Estimate
a) Ratio of Financing Costs to Net Revenue Stream	3.88%	4.76%	5.65%	6.64%	10.55%
b) Capital Expenditure	£2,281,704	£3,686,000	£2,676,900	£7,532,000	£5,085,000
c) Capital Financing Requirement (CFR)	£9,283,109	£11,330,534	£11,303,162	£17,846,939	£20,484,329
d) Net Borrowing and CFR		£13,386,833	£20,484,329	£20,673,877	£20,735,809
e) Incremental impact of new 2010/11 capital investment decisions			£0.41	£3.25	£3.24

Treasury Management Indicators

	2009/10 Actual	2010/11 Original Estimate	2011/12 Estimate	2012/13 Estimate	2013/14 Estimate
a) <u>Authorised Limit for External Debt:</u>					
Borrowing		£15,000,000	£22,500,000	£22,700,000	£22,700,000
Other Long Term Liabilities		£1,500,000	£1,500,000	£1,500,000	£1,500,000
Total Authorised Limit		£16,500,000	£24,000,000	£24,200,000	£24,200,000
b) <u>Operational Boundary for External Debt:</u>					
Borrowing		£14,000,000	£21,500,000	£21,700,000	£21,700,000
Other Long Term Liabilities		£1,500,000	£1,500,000	£1,500,000	£1,500,000
Total Operational Boundary		£15,500,000	£23,000,000	£23,200,000	£23,200,000
c) <u>Upper limit for fixed interest exposure (Max o/s net Borrowing)</u>		£13,500,000	£20,500,000	£20,700,000	£20,700,000
Local indicator-Investment only		100%	100%	100%	100%
Local indicator-Borrowing only		100%	100%	100%	100%
d) <u>Upper limit for variable interest exposure (Max o/s net Borrowing)</u>		£2,000,000	£2,000,000	£2,000,000	£2,000,000
Local indicator-Investment only		100%	100%	100%	100%
Local indicator-Borrowing only		50%	50%	50%	50%
e) <u>Upper limits for maturity structure of outstanding borrowing during 2011/12 (Lower limit 0% in all cases)</u>					
Under 1 year			20%		
1-2 years			25%		
2-5 years			40%		
5-10 years			50%		
Over 10 years			100%		
f) <u>Upper limits for principal sums invested for periods over 364 days</u>					
Maturing beyond 31 March 2012			£5,000,000		
Maturing beyond 31 March 2013			£3,000,000		
Maturing beyond 31 March 2014					