Report to: **Council**

Subject: **Prudential Code Indicators 2005/06 to 2007/08**

Date: **9 February 2005**

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PURPOSE OF REPORT

To seek formal approval of the Prudential Indicators for Gedling Borough Council for the financial years 2005/06 to 2007/08

BACKGROUND

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

- That the capital investment plans of local authorities are affordable, prudent and sustainable.

- That treasury management decisions are taken in accordance with good professional practice

- 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, as 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 Indicators for 2005/06 to 2007/08, which are judged to meet the objectives of the Prudential Code. They represent capital investment plans that are affordable, prudent and sustainable. The Indicators are split into two sections, Estimates and Limits:

Section 1 - Estimates - Details those indicators that are based on expected outcomes, and include four key indicators of the affordability of the authority's capital plans with particular regard to the impact on the Council Tax and Housing Rents. In considering the affordability of capital 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.

1. **Ratio of Financing Costs to Net Revenue Stream**

   Estimates of financing costs include current commitments plus the effect of medium term plan projections in respect of the cost of borrowing.

2. **Incremental Impact of Capital Investment Decisions on Council Tax and Housing Rent**

   This is a key measure of affordability which estimates the incremental impact on the Council Tax and Housing Rent of the capital investment decisions contained within the Medium Term Financial Strategy, 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 and Housing Rent.

3. **Capital Expenditure**

   Estimates of the future capital plans of the authority.

4. **Capital Financing Requirement**

   The Capital Financing Requirement (CFR) measures the authority's underlying need to borrow for capital purposes. In accordance with best professional practice, the Council does not associate borrowing with particular items or types of expenditure. The Authority has an integrated Treasury Management Strategy, and has adopted the CIPFA Code of Practice for Treasury Management in the Public Services. 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 (capital receipts, direct revenue financing etc) the CFR will reduce at the same time, resulting in no net increase.

Section 2 - Limits - Details those indicators that are based on limits, beyond which activities should not pass without management action. They include two key indicators of affordability and five of prudence:

Affordability

1. **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 Council is asked to approve these limits, and to delegate authority to the Head of Finance, within the total limit for any individual year, to effect movement between the separately agreed limits for borrowing and other long term liabilities, 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.

   The Head of Finance 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 Finance 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 2005/06 will be the statutory limit determined under section 3(1) of the Local Government Act 2003.

2. **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 Finance's 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 Council is asked to delegate authority to the Head of Finance, within the total Operational Boundary for any individual year, to effect movement between the separately agreed figures for borrowing and long-term liabilities, in a similar fashion to the Authorised Limit. Any such changes will be reported to the Council at its next meeting following the change.

Prudence

1. **Net Borrowing and the Capital Financing Requirement**

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*"

The Head of Finance confirms that no difficulties are envisaged for the current or future years in respect of this indicator. This view takes into account current commitments, existing plans, and medium term plan projections.

2. **Upper limit for fixed rate interest exposure**
3. **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 investment is used to reduce uncertainty surrounding future interest rate scenarios whilst retaining flexibility to achieve optimum performance through use of variable interest rates.

4. **Upper limits for the maturity structure of borrowing**

   The upper limits for the maturity structure of borrowing are designed 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 therefore avoiding substantial refinancing risks.

5. **Upper limits for principal sums invested for periods over 364 days**

   The upper limit for principal sums invested 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.

RECOMMENDATIONS

Members are asked to approve the Prudential Indicators and Limits for 2005/06 to 2007/08 as detailed in Appendix 1, which have been set with due reference to CIPFA's Prudential Code, under the Local Government Act 2003.