Report to: **Council**

Subject: **Prudential Code Indicators 2009/10 to 2011/12**

Date: **25 February 2009**

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PURPOSE OF REPORT

To seek formal approval of the Prudential Indicators for Gedling Borough Council, for the financial years 2009/10 to 2011/12.

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 Indicators for 2009/10 to 2011/12, 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 - This 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. 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.

The report prepared in 2008/09 assumed the continuing retention of the Housing Revenue Account, and maintenance of the Housing Stock. However, following a positive decision in the tenants' ballot, and the subsequent LSVT in November 2008, Prudential Indicators in respect of the HRA are no longer required.

1. **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 General Fund indicator is expected to be: 5.01% in 2009/10, 4.83% in 2010/11 and 5.46% in 2011/12.

2. **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 2009/10 investment decisions is estimated to be a benefit to the taxpayer of £14.09 per band D property in 2009/10, £18.03 in 2010/11 and £17.99 in 2010/11. This is due to capital investment in car park charging leading to the generation of significant ongoing income. Without such investment, alternative means of balancing the Council's budget over the medium term would be required.

3. **Capital Expenditure**

   This indicator estimates the future capital plans of the authority. Appendix 1 shows that General Fund capital expenditure is expected to be £3.466m in 2009/10, £1.921m in 2010/11 and £2.166m in 2011/12.

4. **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 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 (from capital receipts, direct revenue financing etc) the CFR will reduce at the same time, resulting in no net increase.

   CFR reduced significantly during 2008/09 due to the repayment by CLG of £3.95m overhanging HRA debt, as a result of the LSVT on 3 November 2008. Appendix 1 shows that the Council's CFR is expected to be £10.638m in 2009/10, £11.286m in 2010/11 and £12.090m in 2011/12.

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 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 £14m for 2009/10, £15m for 2010/11 and £16m for 2011/12 in respect of borrowing, and £1.5m for each of the three years in respect of long-term liabilities, giving total Authorised Limits of £15.5m, £16.5m and £17.5m respectively.

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. The proposed Authorised limit for 2009/10 has fallen when compared to the previous report submitted in February 2008, due to the reduction in CFR as a result of the LSVT.

In taking its decisions on this budget report, the Council is asked to note that the Authorised Limit determined for 2009/10 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 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 £13m for 2009/10, £14m for 2010/11 and £15m for 2011/12 in respect of borrowing, and £1.5m for each of the three years in respect of long-term liabilities, giving total Operational Boundaries of £14.5m, £15.5m and £16.5m respectively. As with the Authorised Limit, the proposed Operational Boundary for 2009/10 has fallen when compared to the previous report submitted in February 2008, due to the reduction in CFR as a result of the LSVT.

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*"

   Appendix 1 shows that this indicator is expected to be £12.090m for 2009/10, £12.978m for 2010/11 and £13.393m for 2011/12, 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.

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 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 £12m. 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 £2m. 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 <u>invest</u> 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.

4. **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. This seeks to avoid substantial refinancing risks. It should be noted that the Council takes advice from its Treasury consultants 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% each for maturities under 1 year, between 1 and 2 years, and 35% for maturities between 2 and 5 years. The limit is set at 50% for maturities between 5 and 10 years, and 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.

5. **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 investment beyond 364 days during 2009/10, 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 addition, when the capital receipt in respect of Teal Close is realised, it is anticipated that this will be used to support the capital programme over a number of years. Any outstanding element of this receipt will need to be invested pending its use.

Appendix 1 shows that this indicator is to be set at £5m for sums maturing beyond 31 March 2010 and £3m for sums maturing beyond 31 March 2011. No investment maturing beyond 31 March 2012 is currently envisaged, however, when more certainty regarding Teal Close can be assumed it may be necessary to review this position.

RECOMMENDATIONS

Members are asked to approve the Prudential Indicators and Limits for 2009/10 to 2011/12 as detailed in Appendix 1, which have been set with due reference to CIPFA's Prudential Code, under the Local Government Act 2003.