TELFORD & WREKIN COUNCIL

CABINET – 26 FEBRUARY 2015
COUNCIL - 5 MARCH 2015

PRUDENTIAL INDICATORS

REPORT OF THE CHIEF FINANCE OFFICER (ASSISTANT DIRECTOR: FINANCE, AUDIT & INFORMATION GOVERNANCE)

LEAD CABINET MEMBER – CLLR BILL McCLEMENTS

1. Summary of Main Proposals

1.1 To approve the prudential indicators for 2015/16 to 2017/18 required under the Prudential Code of Capital Finance in Local Authorities.

2. Recommendations

2.1 Members are asked to approve the prudential indicators proposed in this report as part of setting the budget for 2015/16.

3. SUMMARY IMPACT ASSESSMENT

COMMUNITY IMPACT	Do these proposals contribute to specific priorities?	
	Yes/~~No~~	The prudential indicators form part of the Council's service and financial planning strategy and the overall budget and policy framework which is integral to ensuring that available resources are used as effectively as possible in delivering all corporate priority outcomes.
	Will the proposals impact on specific groups of people?	
	~~Yes~~/No	
TARGET COMPLETION / DELIVERY DATE	Prudential Indicators have to be set annually under the Local Government Act 2003.	
FINANCIAL/VALUE FOR MONEY IMPACT	Yes/~~No~~	Where appropriate these are detailed in the body of the report.
LEGAL ISSUES	Yes/~~No~~	CIPFA's Prudential Code is regarded as mandatory guidance associated with the Local Government Act 2003.
OTHER IMPACTS,	Yes/~~No~~	The opportunities and risks associated with

RISKS AND OPPORTUNITIES		the report have been identified and assessed. Arrangements will be put in place to manage the risks and maximise the opportunities that have been identified.
IMPACT ON SPECIFIC WARDS	~~Yes~~/No	

PART B – ADDITIONAL INFORMATION

4. **Summary**

4.1 The Prudential System was introduced from 1 April 2004. Under the Prudential System the Council has to approve Prudential Indicators annually and these are contained in the report.

5. **The CIPFA Prudential Code**

5.1 In September 2003 CIPFA Council approved and subsequently published the final version of the code (updated in 2009), and the concluding paragraph of its executive summary records;

"*The Prudential Code supports the systems of capital investment in local authorities. It is integrated within the wider statutory and management processes of local government. Key elements of the system continue to be determined by legislation, in particular the amount required to be charged to taxation by local authorities in respect of capital investment and the amount and method of government support for capital investment. These will be significant decisions when local authorities take decisions on capital investment.* ***However, the level of capital investment that can be supported will be subject to affordability and sustainability and be a matter for local decision***."

5.2 The general approach of the code is to require the Council to set estimates and limits on its borrowing and features associated with borrowing. The underlying philosophy is that the Council should set limits that ensure borrowing is affordable in the medium to long term. Affordability is determined by the overall amount of borrowing and the interest rate at which it is done. Because borrowing is only permissible (and will remain so) for capital expenditure local authorities have traditionally borrowed at longer term fixed rates of interest (i.e. over 1 year, and typically over 20 years). This helps ensure stability over the medium term; for example a variable rate loan currently at 2.5% may be less attractive than a fixed rate loan at 2.8% if there is thought to be a reasonable possibility that variable rates will rise above 3.2% within a year. To help ensure financial stability the code requires authorities to consider the structure of their borrowing.

5.3 The code also requires authorities with significant investments to set indicators associated with lending money.

5.4 Practically the remaining paragraphs of this section consider the indicators and recommends what the indicators should be for 2015/16. In most cases indicators have to be set for 3 financial years ahead, so figures are also provided for 2016/17 and 2017/18. In proposing these indicators a pragmatic approach has been taken; i.e. known Council plans (including the present treasury structure) have been considered.

5.5 For each indicator, ***the CIPFA requirements of the code are set out in bold italics.*** The limits proposed by the Chief Finance Officer for 2015/16 are then set out. An explanation is provided, unless the indicator and limits are completely self explanatory.

5.6 <u>Prudential Indicators of Affordability – Ratio Affordability Measure</u>

5.6.1 ***The local authority will estimate for the forthcoming financial year and the following two financial years the ratio of financing costs to net revenue stream. This prudential indicator shall be referred to as estimates of ratio of financing costs to net revenue stream.***

5.6.2 In Telford & Wrekin's case this indicator makes more sense if Local Government Reorganisation (LGR) debt paid over to Shropshire Council is included***.***

Revenue Budget	
Year 1(2015/16)	4.78%
Year 2(2016/17)	4.78%
Year 3(2017/18)	5.11%

5.6.3 The indicator has been calculated as debt interest costs divided by budget requirement for the general fund element. The general fund indicator above shows a slight increase in the ratio (This broadly matches the expected prudential borrowing which is noted in 5.10.2 and the cuts in grants impacting on net revenue stream).

5.7 <u>Prudential Indicators of Affordability – Incremental Council Tax Affordability Measures</u>

The local authority will

(i) forecast the total budgetary requirements for the authority based on no changes to the existing capital programme

(ii) forecast the total budgetary requirements for the authority with the changes to the capital programme included in the calculation

(iii) take the difference between (i) and (ii) and calculate the addition or reduction to Council tax that would result.

This prudential indicator will be referred to as estimates of the incremental impact of new capital investment decisions on the Council Tax and shall be expressed in the following manner £ xx.xx.

5.7.1 The indicator is calculated by taking the estimates of capital included in the Capital Budget Report, assuming it is financed through a mixture of borrowing and use of capital receipts (with interest at 4.5% ongoing, with Minimum Revenue Provision calculated in line with the MRP policy as detailed in the Treasury Strategy Report) and dividing them by the tax base (45,191.7). The indicator works on a cumulative basis (i.e. the year 2 indicator includes the full year cost of year 1 expenditure, together with the part year cost of that year's programme), but only part year interest cost in the year expenditure is incurred.

5.7.2 The estimate of the incremental impact on Council Tax (Band B) of capital decisions proposed over and above capital investment decisions that have already been taken by the Council are as follows;

Year	**Prudential Borrowing £**	**Total £**
2015/16	22.08	**22.08**
2016/17	24.61	**24.61**
2017/18	25.68	**25.68**

5.7.3 Prudential Indicators of Affordability – Incremental Housing Rent Affordability Measures

This Indicator does not apply to Telford & Wrekin Council.

5.8 ***Estimates of Capital Financing Requirement***

The local authority will make reasonable estimates of the total capital financing requirement at the end of the forthcoming financial year and the following two years. These prudential indicators shall be referred to as:
Estimate of capital financing requirement as at the end of years 1, 2 and 3.

5.8.1 The capital financing requirement is a concept in the Prudential System, but can simply be understood as the Council's underlying need to borrow money over the long term. The code requires that the figure is calculated gross, to include debt that is paid for by other authorities following LGR, so in Telford & Wrekin's case, these figures have limited meaning, and locally the indicator needs adjusting for LGR debt.

5.8.2 Table A shows the estimated cumulative capital financing requirement at a point in time. These estimates now include the impact of the Public Finance Initiative.

	Total CFR
31/3/2015	£313.5m
31/3/2016	£363.1m
31/3/2017	£336.8m
31/3/2018	£328.7m

5.8.3 The movement in the CFR is consistent with other planning assumptions.

5.8.4 Gross Debt and Capital Finance Requirement. The purpose of this treasury indicator is to highlight a situation where the Council is planning to borrow in advance of need. If these figures exceed CFR (which they don't) they would indicate we are borrowing in advance of need.

	Outstanding Borrowing (at nominal value)	Other Long-term Liabilities (at nominal value)	**Gross Debt**
31/3/2015	£148.5m	£58.8m	£207.3m
31/3/2016	£203.9m	£57.6m	£261.5m
31/3/2017	£183.7m	£58.1m	£241.8m
31/3/2018	£181.8m	£56.2m	£238.0m

5.9 Treasury Management Prudential Indicators

5.9.1 The Council adopted the revised ***CIPFA Code of Practice for Treasury Management in the Public Services*** at its meeting in March 2010. Treasury Management Practices (TMPs) have been established by the Chief Finance Officer in line with the advice of our Treasury Advisors, and are kept up to date with support from Arling Close our current Treasury Advisors. ***The first prudential indicator in respect of treasury management is that the local authority has adopted the CIPFA Code*** is therefore met.

5.10 Capital Expenditure and Capital Commitments Prudential Indicators

5.10.1 ***The local authority will make reasonable estimates of the total of capital expenditure that it plans to incur during the forthcoming financial year and at least the following two financial years. These prudential indicators shall be referred to as:***

Estimate of total capital expenditure to be incurred in years 1, 2 and 3

5.10.2 The budget and capital report to Council for 2015/16 identifies programmed capital schemes, and subsequent year's capital needs. The estimates of capital expenditure to be incurred are therefore;

	Supported Borrowing	Prudential Borrowing	Grant Funded	Revenue/ External	Capital Receipts	Total
	£m	£m	£m	£m	£m	£m
2015/16	1.268	54.147	25.334	3.879	25.752	110.380
2016/17	0.000	-20.159	13.513	4.725	31.368	29.447
2017/18	0.000	-1.960	4.586	0.200	7.775	10.601

It is only the two columns relating to borrowing that impact on prudential indicators. Tese figures include the Housing Company and associated Property Investment Portfolio scheme, but not the MOD scheme.

5.11 **<u>External Debt Prudential Indicators</u>**

5.11.1 ***The local authority will set for the forthcoming financial year and the following two financial years a prudential limit for its total external debt, gross of investments, separately identifying borrowing from other long term liabilities. This prudential indicator shall be referred to as:***

<u>Authorised limit for external debt</u> = authorised limit for borrowing + authorised limit for other long term liabilities for years 1, 2 and 3.

5.11.2 The recommended Authorised Limit for External Debt for:

Year 1 (2015/16) is £327m for borrowing and £63m for other long term liabilities

Year 2 (2016/17) is £308m for borrowing and £62m for other long term liabilities

Year 3 (2017/18) is £309m for borrowing and £61m for other long term liabilities

5.11.3 This limit represents the maximum amount the Council may borrow at any point in time in the year. It has to be set at a level the Council considers is "prudent". (This limit is analogous to the limit on borrowing set out in section 44 of the 1989 Act). Because it is ultra vires to exceed, the authorised limit must be set so as to avoid circumstances in which the Council would need to borrow more money than this limit. The limit has been set sufficiently high to accommodate the spend on the MOD scheme should it go ahead.

5.11.4 Other long term liabilities include items that would appear on the balance sheet of the Council that are analogous to borrowing. For example, the capital cost of leases would be included.

5.12 ***Operational Boundary***

The local authority will also set for the forthcoming financial year and the following two years an operational boundary its total external debt, gross of investments, separately identifying borrowing from other long term liabilities. This prudential indicator shall be referred to as the:

Operational Boundary = operational boundary for borrowing + operational boundary for other long term liabilities for years 1, 2 and 3.

5.12.1 The operational boundary is a measure of the most money the Council would normally borrow at any time during the year. The code recognises that circumstances might arise when the boundary might be exceeded temporarily, but suggest a sustained or regular pattern of borrowing above this level ought to be investigated, as a potential symptom of a more serious financial problem. The limit has been set sufficiently high to accommodate the spend on the MOD scheme should it go ahead.

5.12.2 The Recommended Operational boundary for External debt is

Year 1 (2015/16) is £309m for External debt for and £61m for other long term liabilities

Year 2 (2016/17) is £289m for External debt for and £61m for other long term liabilities

Year 3(2017/18) is £290m for External debt for and £60m for other long term liabilities

5.13 **Interest Rate Exposure**

5.13.1 ***The local authority will set, for the forthcoming year and the following two years, limits to its exposures to the effects of changes in interest rates. These prudential indicators will relate to both fixed interest rates and variable interest rates and will be referred to respectively as the upper limits on fixed and variable interest rate exposures.***

5.13.2 There is no requirement in the code to set lower limits; however, given the risks associated with having excessively high relatively short fixed, or variable rate borrowing, it is suggested that lower limits are set locally for longer maturing fixed rate borrowing.

5.13.3 ***Variable rate exposures***

Borrowing that is at variable rates LESS Investments that are variable rate investments

We have a proportion of our investments that are at variable rates and exceed in total the level of debt we currently have at variable rates (historically a high proportion of debt has been at fixed rates). The limits proposed are as follows;

	Net Variable Limit %
2015/16	30
2016/17	30
2017/18	30

5.13.4 The upper limit replaces the existing (1989 Act) Section 44 limit "the maximum proportion of borrowing which is subject to variable rate interest". Whilst 30% has been set forward as a limit, in practice it would be unusual for the exposure to exceed 15%. Limits for years 2 & 3 assume no substantial change in market conditions.

5.13.5 Because of our position of holding investments it would be helpful to set a local indicator for setting a maximum exposure for variable rates as a percentage of total investment plus total debt. The limit proposed would be as follows;

	Upper Limit
2015/16	60%
2016/17	60%
2017/18	60%

5.13.6 *Fixed Interest Rate Exposure*

The local authority will set, for the forthcoming year and the following two years, both upper and lower limits for its exposure to fixed interest rate risk calculated as follows and each expressed as total borrowing less total investments:

Fixed interest rate exposures
Borrowing that is at fixed rates LESS Investments that are fixed rate investments

Expressed as a percentage or absolute of total borrowing less investments.

5.13.7 The limits (expressed as an absolute of total fixed borrowing less total fixed investments) proposed are as follows;

Fixed Rate Risk

	Upper Limit	Lower Limit
2015/16	100%	70%
2016/17	100%	70%
2017/18	100%	70%

In principle, it may be necessary / desirable for all borrowing at a point in time to be at a fixed rate. The lower limit is effectively the counterpart to the upper limit for variable rate exposure.

5.14 ***Prudential limits for the maturity structure of fixed rate borrowing***

The local authority will set for the forthcoming year both upper and lower limits with respect to the maturity structure of its borrowing, calculated as follows

Amount of projected borrowing that is fixed rate maturing in each period
Expressed as a Percentage of
Total projected borrowing that is fixed rate at the start of the period.
where the periods in question are

- ***Under 12 months***
- ***1 year and within 2 years***
- ***2 years and within 5 years***
- ***5 years and within 10 years***
- ***10 years and within 20 years***
- ***20 years and within 30 years***
- ***30 years and within 40 years***
- ***40 years and within 50 years***
- ***50 years+***

5.14.1 The proposed prudential limits are as follows;

Maturity	Lower Limit %	Upper Limit %	Actual % for 31/03/14
Under 12 months	0	50	30
1-2 years	0	30	1
2-5 years	0	50	2
5-10 years	0	75	1
10-20 years	0	75	0
20-30 years	0	75	0
30-40 years	0	100	12
40-50 years	10	100	14
Over 50 years	15	100	40

5.14.2 Under the investment guidance issued by CLG the Council needs to set indicators for ***principal sums invested for periods longer than 364 days*****.** It is recommended that we set the following limit

Maximum principal investment that can be invested for more than 364 days

Financial Year	Upper Limit
2015/16	95%
2016/17	95%
2017/18	95%

6. Financial Implications

6.1 The prudential indicators provide a framework for 2015/16 in which the Council conducts its treasury activities, consistent with good treasury risk management.

6.2 The code indicates that "in all cases, the process of setting prudential indicators for treasury management should be accompanied by a clear and integrated forward treasury management strategy, and a recognition of the pre-existing structure of the authority's borrowing and investment portfolios." The indicators proposed here take account of the existing structure of borrowing and all reasonable restructuring activity that might occur.

6.3 The code requires the following matters to be taken into account when setting or revising prudential indicators

(a) option appraisal for all projects, i.e. value for money
(b) asset management planning, i.e. stewardship of asset
(c) strategic planning for the authority, i.e. service objectives
(d) achievability of the forward plan, i.e. its practicality
(e) implications for external borrowing, i.e. prudence
(f) implications for Council Tax and housing rents, i.e. affordability.

Items (a)-(c) are largely considered in the current arrangements as part of the asset management planning / corporate capital strategy processes. Items (d) and (f) in financial terms have been taken account of by the Chief Finance Officer in presenting the budget and item (e) is inherent to the prudential indicator setting process.

7. Background Papers

Local Government Act 2003
CIPFA Prudential Code for Capital Finance in Local Authorities
Guidance on Local Authority Investments