

TELFORD & WREKIN COUNCIL

**CABINET – 15 FEBRUARY 2018
COUNCIL - 1 MARCH 2018**

PRUDENTIAL INDICATORS

REPORT OF THE CHIEF FINANCE OFFICER (ASSISTANT DIRECTOR: FINANCE & HUMAN RESOURCES)

LEAD CABINET MEMBER – CLLR LEE CARTER

1. Summary of Main Proposals

- 1.1 To consider the prudential indicators for 2018/19 to 2020/21 required under the Prudential Code of Capital Finance in Local Authorities and to approve the indicators for 2018/19.

2. Recommendations

- 2.1 Members are asked to approve the prudential indicators proposed in this report as part of setting the budget for 2018/19.
- 2.2 Members are asked to delegate authority to the Council's Section 151 Officer, after consultation with the Chair of the Audit Committee and the Cabinet Member for Finance, Commercial Services & Economic Development to make any amendments required arising from the potential changes to the Prudential Code for Capital Finance.

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,
RISKS AND
OPPORTUNITIES**

Yes/No The opportunities and risks associated with 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 The **Local Government Act 2003** requires the Authority to have regard to the Chartered Institute of Public Finance and Accountancy's *2011 Prudential Code for Capital Finance in Local Authorities* (as amended in 2012) (the Prudential Code) when determining how much money it can afford to borrow. The objectives of the Prudential Code are to ensure, within a clear framework, that the capital investment plans of local authorities are affordable, prudent and sustainable, and that treasury management decisions are taken in accordance with good professional practice.

5.2 It should be noted that the Department for Communities and Local Government (DCLG) issued a consultation paper which closed on 22 December on proposed changes to the Prudential Framework of Capital Finance and is intended to be effective from 1 April 2018. On 11 January 2018, the Municipal Journal reported that the Local Government Association "has called for any changes to be deferred to 2019/20, as implementation from April, as proposed would cause significant problems for councils". Clearly, until the changes are finalised it is not possible to assess any financial implications for the Council. This report therefore seeks a delegation to the Council's Section 151 Officer to make any changes to reflect the final DCLG proposals after consultation with the Chair of the Audit Committee and the Cabinet Member for Finance, Commercial Services & Economic Development.

5.3 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.

- 5.4 The code also requires authorities with significant investments to set indicators associated with lending money.
- 5.5 Practically the remaining paragraphs of this section consider the indicators and recommends what the indicators should be for 2018/19. In most cases indicators have to be set for 3 financial years ahead, so figures are also provided for 2019/20 and 2020/21. In proposing these indicators a pragmatic approach has been taken; i.e. known Council plans (including the present treasury structure) have been considered.
- 5.6 For each indicator, ***the CIPFA requirements of the code are set out in bold italics.*** The limits proposed by the Chief Finance Officer for 2018/19 are then set out. An explanation is provided, unless the indicator and limits are completely self-explanatory.

5.7 Prudential Indicators of Affordability – Ratio Affordability Measure

5.7.1 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.

5.7.2 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(2018/19)	7.45%
Year 2(2019/20)	8.04%
Year 3(2021/22)	8.77%

5.7.3 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 between 2018/19 and 2019/20 (this broadly matches the expected prudential borrowing which is noted in 5.11.2 and the cuts in grants impacting on net revenue stream).

5.8 Prudential Indicators of Affordability – Incremental Council Tax Affordability Measures

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.

5.8.1 The indicator is calculated by taking the estimates of new capital investments included in the Capital Programme Report, assuming it is financed through a mixture of borrowing and use of capital receipts (with interest at 3.5% 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 (49,579.8). 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.

5.8.2 The estimate of the incremental impact on Council Tax (Band B – as the average property in the Borough falls in to this band) of capital decisions proposed over and above capital investment decisions that have already been taken by the Council are as follows;

<u>Year</u>	<u>Prudential Borrowing</u> £
2018/19	0.74
2019/20	1.26
2020/21	2.10

5.8.3 Prudential Indicators of Affordability – Incremental Housing Rent Affordability Measures

This Indicator does not apply to Telford & Wrekin Council as the Council does not operate “council housing through a Housing Revenue Account”.

5.9 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.***

5.9.1 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 Local Government Reorganisation (LGR), so in Telford & Wrekin’s case, these figures have limited meaning, and locally the indicator needs adjusting for LGR debt.

5.9.2 Table A shows the estimated cumulative Capital Financing Requirement (CFR) at a point in time. These estimates include the impact of the Public Finance Initiative.

	Total CFR
31/3/2018	£425.0m
31/3/2019	£467.8m
31/3/2020	£479.3m
31/3/2021	£481.8m

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

5.9.4 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
31/3/2018	£276.8m	£56.3m	£333.1m
31/3/2019	£320.1m	£54.0m	£374.1m
31/3/2020	£334.9m	£51.7m	£386.6m
31/3/2021	£339.4m	£50.5m	£389.9m

5.10 Treasury Management Prudential Indicators

5.10.1 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 Arlingclose our Treasury Advisors. ***The first prudential indicator in respect of treasury management is that the local authority has adopted the CIPFA Code*** is therefore met.

5.11 Capital Expenditure and Capital Commitments Prudential Indicators

5.11.1 ***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

5.11.2 The budget and capital report to Council for 2018/19 identifies programmed capital schemes, and subsequent year's capital needs. The estimates of capital expenditure to be incurred are therefore;

	Prudential Borrowing	Grant Funded	Revenue/ External	Capital Receipts	Total
	£m	£m	£m	£m	£m

2018/19	43.287	17.019	13.418	10.943	84.667
2019/20	14.793	20.130	5.145	6.734	46.802
2020/21	4.454	5.130	0.407	10.412	20.403

It is only the column relating to prudential borrowing that impacts on prudential indicators. These figures include further investment in NuPlace, the Council's wholly owned Housing Company, and Property Investment Portfolio schemes which should generate returns for the Council well in excess of the associated debt charges

5.12 **External Debt Prudential Indicators**

5.12.1 ***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:***

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

5.12.2 The recommended Authorised Limit for External Debt for:

Year 1 (2018/19) is £440m for borrowing and £61m for other long term liabilities

Year 2 (2019/20) is £450m for borrowing and £60m for other long term liabilities

Year 3 (2020/21) is £450m for borrowing and £59m for other long term liabilities

5.12.3 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.

5.12.4 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.

5.13 **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.

5.13.1 The operational boundary is a measure of the maximum amount that 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.

5.13.2 The Recommended Operational boundary for External debt is

Year 1 (2018/19) is £420m for External debt for and £59m for other long term liabilities

Year 2 (2019/20) is £430m for External debt for and £58m for other long term liabilities

Year 3 (2020/21) is £430m for External debt for and £57m for other long term liabilities

5.14 Interest Rate Exposure

5.14.1 ***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.***

5.14.2 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.

5.14.3 Variable rate exposures

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

The limits proposed are as follows;

	Net Variable Limit
	%
2018/19	70
2019/20	70
2020/21	70

5.14.4 We have also 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
	%
2018/19	70
2019/20	70
2020/21	70

5.14.6 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.

5.14.7 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 %
2018/19	100	70
2019/20	100	70
2020/21	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.

5.15 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+**

5.15.1 The proposed prudential limits are as follows;

Maturity	Lower Limit %	Upper Limit %	Actual % for 31/03/17
Under 12 months	0	70	54
1-2 years	0	30	1
2-5 years	0	50	2
5-10 years	0	75	2
10-20 years	0	75	2
20-30 years	0	75	0
30-40 years	0	100	11
40-50 years	10	100	10
Over 50 years	15	100	18

5.15.2 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
2018/19	95%
2019/20	95%
2020/21	95%

6. Financial Implications

- 6.1 The prudential indicators provide a framework for 2018/19 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 where applicable), 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