

PRUDENTIAL CODE AND CAPITAL PROGRAMME

1. The Prudential Code

Since April 2004 local authorities have had the power to borrow to fund capital schemes without central government approval, but prior to doing so, we are required to determine whether or not it is prudent to do so. The mechanism for this is to look at a series of indicators known as prudential indicators intended to measure the extent of our debts and our ability to pay them back. We set these out at the time of setting the revenue budget and capital programme whether or not we are actually planning to use these powers to borrow.

The purpose of this report is to set out the requirements to determine prudential indicators for the forthcoming financial year 2006/07. The main requirements are as follows: -

- To determine estimates of capital expenditure for the forthcoming year and the two years thereafter. (See Table 1.)
- To determine the capital finance requirement (mainly, the amount of capital expenditure to be financed by borrowing) for each of these years. (See Table 3.)
- To estimate the ratio of capital financing costs to net revenue streams and the impact on the Council Tax and housing rents. (See Tables 4 and 5.)
- To set an operational boundary for the Council's external debt for the forthcoming year and the two years thereafter. (See Table 6.)
- To set an authorised limit for its external debt for the forthcoming year and the two years thereafter. (See Table 7.)
- To set prudential indicators in respect of treasury management. (See sections 6.1 to 6.4 of the report and Tables 8 and 9.)

In setting prudential indicators, the Council is required to have regard to the following: -

- Affordability, e.g. implications for Council Tax and Council housing rents.
- Prudence and sustainability, e.g. implications for external borrowing
- Value for money, e.g. option appraisal
- Stewardship of assets, e.g. asset management planning

2. Determination of estimates of capital expenditure 2006/07 to 2008/09

Table 1 overleaf sets out the overall estimated level of capital expenditure on HRA and non-HRA services.

Table 1. (Estimates of capital expenditure)

	Total	2005/06	2006/07	2007/08	2008/09
	£000s	£000s	£000s	£000s	£000s
Programme reported to Cabinet 15 th Dec 2005	330,500.7	140,783.0	104,972.6	59,914.8	24,830.3
Changes	53,071.9	1,377.7	18,554.9	11,328.7	21,811.2
Programme now estimated	383,572.6	142,160.7	123,526.9	71,243.5	46,641.5
Comprising:					
Non HRA services	225,373.4	67,305.7	86,476.9	44,643.5	26,947.3
HRA Services	158,199.2	74,855.0	37,050.0	26,600.0	19,694.2
Total	383,572.6	142,160.7	123,526.9	71,243.5	46,641.5

In building up these estimates, the following information has been used: -

- The 3 year capital programme up to 2007/08 plus commitments into 2008/09.
- The capital allocations announced by central government for housing, transport, social services and education. It has been assumed that the Council will wish to dedicate these resources to the services that central government has identified.
- The HRA capital programme for 2005/06 is set at £74.9 million in accordance with the report elsewhere on the agenda. For 2006/07 and 2007/08 it has been estimated at £37.1 million and £26.6 million respectively. These estimates are based upon known borrowing approvals, the likely available level of the Major Repairs Allowance and internal HRA resources.
- Estimates of vehicle and equipment replacement programmes that are funded by operating leases and prudential borrowing
- The addition of annual programmes in 2008/09. None of these programmes are self-financing and are effectively supported by the Capital Receipts programme (see section 4 below). The programme is as follows :-

	£000s
Capitalised repairs	2,300
Deferred Purchase Payments	299
Aids & Adaptations	2,500
General land Disposal Facilitation Budget	100
	5,199

- The existing programme has also been subject to review, and amendments in the form of cost changes and re-phasing to future years incorporated.

3. Determination of the capital financing requirement

The Prudential Code requires that estimates of the capital financing requirement should be produced – the balance between the use of receipts, borrowing and revenue resources.

The starting point for these calculations is the aggregation of certain figures in the latest balance sheet, in this case 31st March 2005. This figure is then affected each year in the following way.

- It increases as capital expenditure is incurred.
- It is reduced to the extent that that expenditure is financed by government grants, capital receipts, direct revenue funding and use of external contributions.
- It is reduced by the statutory charge to revenue (Minimum Revenue Provision) or any voluntary contributions from revenue (as is the case with the HRA)

An assessment has been made of the financing sources that will fund the capital expenditure estimates. In making this assessment the following assumptions have been made.

- Supported borrowing has been calculated from the allocations given by central government. Some government departments have given provisional allocations for 2006/07 others have not. No indications of allocations have been given for 2007/08. In the absence of this information, I have made reasonable estimates for the purposes of forward planning.
- Unsupported borrowing has been included to fund items of plant and equipment that were formerly leased together with approved boiler replacement schemes, approved Adult Services revenue saving schemes, the phasing of the Special Education Review proposals (£2.6m), the projected costs of Leigh Sports Village (LSV) Pool (£3m), and the delay between LSV construction costs and receipt of grant (£12m). A report elsewhere on the agenda details for Cabinet's information progress on the Leigh Sports Village scheme. The business plan for the Leigh Sports Village Company (which will be majority controlled by the Council) and the management agreement for the operation of the Sports Hall and Pool (the responsibility of Wigan Leisure and Cultural Trust), will need to be reviewed in the light of more recent proposals to replace the Wigan International Pool on the existing site. The original Getting Wigan Active strategy envisaged the closure of Tyldesley pool and a replacement pool at Robin Park with the existing running costs being used to fund similar costs at Leigh. The final tender prices and construction timetable will also impact on the business plan. Agreement needs to be reached on initial start up costs for

the Company and how these are funded. These may impact on the level of revenue and capital support the scheme requires.

- Capital receipts from Right to Buy sales have been re-assessed by the ALMO. In the last review of the programme in December 2005 a reassessment of receipts had been carried out for the years 2005/06 to 2007/08. The programme now reported assumes an increase in the period to March 31st 2009 of a further £3.4 million usable capital receipts.
- It has been agreed with the Director of Legal and Property Services that the land disposal programme will generate receipts in the region of £8.4 million taking 2005/06 and 2006/07 together, and then a further £2.2 million for the years 2007/08 and 2008/09. It will be necessary for the Council in due course to determine the source of these receipts for the later years.
- The HRA programme will be funded by a combination of the Major Repairs Allowance, borrowing and the HRA's own resources.
- Operating leases are assumed for the purposes of this report to be the source of finance for vehicle replacements. The prudential regime allows the Council to consider the use of unsupported borrowing instead of operating leases if this is considered to be the best option. Options are currently being appraised to determine the most effective way of financing such purchases. Progress in using borrowing instead of leasing was made in 2004/05 for specialist vehicles.
- Grants and external contributions have been assessed to match expenditure under the various regimes.

Table 2. (Resourcing the capital programme)

	2005/06	2006/07	2007/08	2008/09
	£'000	£'000	£'000	£'000
Total Spend requiring funding	142,160.7	123,526.9	71,243.5	46,641.5
Borrowing – supported	53,359.7	8,637.1	5,279.7	5,282.0
Borrowing – unsupported	10,402.0	7,925.6	1,008.0	1,000.0
External contributions	6,729.7	3,815.8	1,141.1	585.6
Capital receipts	20,453.2	29,815.1	15,108.7	5,358.1
Government Grants	19,744.1	29,158.2	25,008.2	12,598.3
Operating leases	2,604.0	3,705.0	2,000.0	2,000.0
Direct Revenue funding – General Fund	415.7	170.0	0	0
Direct Revenue funding - HRA	14,105.0	19,500.0	10,100.0	6,100.0
HRA Resources – Major Repairs Allowance	18,700.0	14,800.0	14,100.0	11,800.0
Sub total	146,513.4	117,526.8	73,745.7	44,724.0
In year position	4,352.7	(6,000.1)	2,502.2	(1,917.5)
Cumulative	4,352.7	(1,647.4)	854.8	(1,062.7)

As a consequence of this spending programme and its funding, the capital financing requirement is estimated to change as follows over the period of this review.

Table 3. (The estimated capital financing requirement)

	HRA capital financing requirement	Non-HRA capital financing requirement	Total capital financing requirement
	£'000	£'000	£'000
Estimated at 31 st March 2006	217,595	218,579	436,174
Change in 2006/07	0	6,533	6,533
Estimated at 31 st March 2007	217,595	225,112	442,707
Change in 2007/08	0	-4,122	-4,122
Estimated at 31 st March 2008	217,595	220,990	438,585
Change in 2008/09	-4,352	-3,962	-8,314
Estimated at 31 st March 2009	213,243	217,028	430,271

4. Estimating the ratios of capital financing costs to net revenue streams and the impact on Council Tax and rents.

The Council is required to calculate for 2006/07, 2007/08 and 2008/09 the relationship between financing costs and the net revenue stream.

Financing costs refer mainly to: -

- Interest payable on borrowing and other long-term liabilities.
- The Minimum Revenue provision
- Investment income.

Net revenue stream refers to: -

- For non-HRA services - The amount in the consolidated revenue account for expenditure to be met from government grants and local taxpayers. Assumed in this report to equate to the budget requirement.
- For the HRA - The amount met from rents and government grants.

Table 4 sets out the calculations

Table 4. Ratio of capital financing costs to revenue streams

	2006/07	2007/08	2008/09
Non - HRA services			
Estimated financing costs (£'000)	20,331	20,755	20,734
Estimated net revenue stream (£'000)	210,075	217,086	223,934
Ratio of financing costs to net revenue (%)	9.68%	9.56%	9.26%

HRA	2006/07	2007/08	2008/09
Estimated financing costs (£'000)	15,215	15,546	19,587
Estimated net revenue stream (£'000)	66,582	67,194	67,924
Ratio of financing costs to net revenue (%)	22.85%	23.14%	28.84%

In addition, the Council is required to show the incremental impact of capital investment decisions on the Council Tax and housing rents. For the purposes of this report the incremental impact has been calculated as the financial consequences of the unsupported borrowing and any revenue consequences other than financing costs.

Table 5 sets out the calculations.

Table 5. Impact on Council Tax and Housing Rents

		2006/07	2007/08	2008/09
Non - HRA services				
Estimated budget requirement with capital programme at estimated levels for 2005/06 to 2007/08 (£'000)	A	210,075	217,086	223,934
Estimated budget requirement with capital programme estimates excluding unsupported borrowing. (£'000)	B	208,654	215,130	221,978
Non financing costs arising from capital programme included in "A" (£'000)	C	124	145	145
Effect on budget requirement of removing unsupported borrowing and other revenue costs (£'000)	(A-B) +C	1,545	2,101	2,101
Cumulative effect on Council Tax (reduction) (£.p)		16.43	38.79	61.14
Year on year effect on Council Tax (reduction) (£.p)		16.43	22.36	22.35

Table 5. cont

HRA				
Estimated amount to be met by income from rents etc with capital programme at estimated levels for 2005/06 to 2007/08 (£'000)	A	60,400	63,000	65,900
Estimated amount to be met by income from rents etc with capital programme estimates excluding unsupported borrowing. (£'000)	B	60,400	63,000	65,900
Non financing costs arising from capital programme included in "A" (£'000)	C	0	0	0
Effect on budget requirement of removing unsupported borrowing and other revenue costs (£'000)	(A-B) +C	0	0	0
Cumulative effect on rents (£.p)		0	0	0
Year on year effect on rents (£.p)		0	0	0

5. Setting the Authorised Limit and the Operational Boundary for external debt

The Council is required to set these two limits to its external debt. External debt refers to borrowing and other long-term liabilities e.g. deferred purchase schemes and from 2006/07 leasing arrangements.

Both the authorised limit and operational boundary need to be consistent with the Council's plans for capital expenditure and financing and with its treasury management policy statement and practices.

The operational boundary is to directly link into the Council's plans for capital expenditure, the estimates of the capital financing requirement and the estimate of the cash flow requirements for all other purposes, including revenue.

The estimate of the balance outstanding at March 2006 is within the approved operational boundary identified in the Prudential report to Cabinet of 17th February 2005.

I have set out in Table 6, the calculation of the operational boundary for the years 2006/07 to 2008/09.

Table 6. The Operational Boundary

	Borrowing	Other Long Term Liabilities	Total External Debt
	£'000	£'000	£'000
For 2006/07			
Amounts currently Outstanding	369,042	814	369,856
2006/07 cash flows			
Replacement of loans due for repayment	732		732
Use of surplus capital resources at 31.3.06	170		170
Capital Financing requirement 2006/07	16,563	2,000	18,563
Revenue set aside (Minimum Revenue Provision etc)	-9,637	-745	-10,382
Estimated operational boundary at 31.3.2007	376,868	2,069	378,937
2007/08 cash flows			
Replacement of loans due for repayment	753		753
Use of surplus capital resources at 31.3.07	0		0
Capital Financing requirement 2007/08	6,288	2,000	8,288
Revenue set aside (Minimum Revenue Provision etc)	-10,291	-770	-11,061
Estimated operational boundary at 31.3.2008	373,617	3,299	376,916
2008/09 cash flows			
Replacement of loans due for repayment	10,749		10,749
Use of surplus capital resources at 31.3.08	0		0
Capital Financing requirement 2008/09	6,282	2,000	8,282
Revenue set aside (Minimum Revenue Provision etc)	-10,244	-799	-11,043
Estimated operational boundary at 31.3.2009	380,404	4,500	384,904

The calculation of the Authorised Limit should provide headroom over and above the operational boundary to allow for unusual cash movements. It is therefore recommended that the Authorised Limit allow for a 5% variation on the operational boundary to allow for such headroom. On this basis the Authorised Limit would be as shown in Table 7.

Table 7. The Authorised Limit

	Borrowing	Other Long Term Liabilities	Total External Debt
	£m	£m	£m
For 2006/07	395.7	2.2	397.9
For 2007/08	392.3	3.5	395.8
For 2008/09	399.4	4.7	404.1

6. Treasury Management Prudential Indicators

The Council determines a Treasury Management Policy Statement prior to the start of the financial year and this will continue to be done. Under the prudential code, there are certain aspects of this policy that need to be determined now and which are the subject of this report.

These indicators are in respect of: -

The Treasury Management Code of Practice

Interest rate exposures.

The maturity structure of borrowing

The total principal sums invested for periods longer than 364 days.

6.1 Code of Practice.

It is confirmed that the Council has adopted the CIPFA Code of Practice for Treasury Management in the Public Services.

6.2 Interest rate exposures

The Council is required to set upper limits to its exposures to the effects of changes in interest rates for both fixed interest rate and variable rate loans.

It has been Council policy to borrow at fixed rates of interest and it is recommended that this will continue. However, for the purposes of these calculations, loans and investments of less than 365 days are classed as variable rate. These transactions are used to assist the Council's day to day cash flows and a prudent level of exposure has been set at a net figure of £10million in each of the 3 years.

Table 8 sets out the calculation of the upper limits for fixed rate and variable rate loans for the period in question.

Table 8. (Calculation of upper limits for fixed and variable rate loans)

	2006/07	2007/08	2008/09
	£'000	£'000	£'000
Fixed rate exposure			
Estimated fixed rate borrowing (at operational boundary)	376,868	373,617	380,404
Less :- value of investments held at fixed rates	0	0	0
Upper limit on fixed rate exposure	376,868	373,617	380,404
Variable rate exposure			
Estimated variable rate borrowing	25,000	25,000	25,000
Less :- value of investments held at variable rates	15,000	15,000	15,000
Upper limit on variable rate exposure	10,000	10,000	10,000

6.3 The maturity structure of borrowing

The Council is required to set for the forthcoming year only both upper and lower limits with respect to the maturity structure of its projected fixed rate borrowing. The limits are to be expressed as percentages of total projected borrowing. The recommended limits are shown in Table 9.

Table 9. (Maturity structure of projected borrowing)

	Upper limit	Lower limit
	%	%
Under 12 months	0	0
12 months and within 24 months	0	0
24 months and within 5 years	50	0
5 years and within 10 years	50	0
10 years and above	100	50

The maturity profile that is actually chosen for new borrowing would depend on prevailing market conditions, the acceptance of the above limits will give reasonable flexibility in that it would allow: -

- All new borrowing (but no less than 50%) to be taken out for 10 years or more.
- Up to 50% of new borrowing to be taken out for periods of 2 to 10 years.
- No borrowing for less than 2 years.

6.4 The total principal sums invested for periods longer than 364 days.

The Council is required to set a prudential limit on sums invested for periods longer than 364 days.

It is not envisaged that there would be any investments held for more than 364 days.

7. Controlled companies

The code requires an authority, which has interests in companies, to have regard to its financial commitments and obligations to those companies in its application of the code.

The Wigan Metropolitan Development Company, a controlled company, has external borrowings of £183,320, which it will pay off from its revenue during 2006/07. The Company has no current programme for further capital investment. The Leigh Sports Village Company, again a controlled company will commence trading during the period of this forecast. A detailed financial forecast is being prepared and the implications will need to be considered in a future Cabinet report.

8. Recommendations

The various prudential indicator requirements contained within this report are summarised explicitly within this section.

The Council is recommended to set the following prudential indicators and treasury management objectives as set out in table 10.

Table 10. (Summary of Prudential Indicators)

	Indicator	2006/07	2007/08	2008/09
	Capital Spending			
1.	Estimated capital expenditure (£)	£123,526,900	£71,243,500	£46,641,500
2.	Estimated capital financing requirement (£)	£442,707,000	£438,585,000	£434,271,000
	Capital Financing Ratios			
3.	Non HRA Services - estimated ratios of capital financing costs to net revenue streams (%age)	9.68%	9.56%	9.26%
4.	HRA Services - estimated ratios of capital financing costs to net revenue streams (%age)	22.85%	23.14%	28.84%
	Impact on Revenue			
5.	Incremental impact of Capital Expenditure Decisions on Council Tax (£.p)	£16.43	£22.36	£22.35
6.	Incremental impact of Capital Expenditure Decisions on Council House Rents (£.p)	Nil	Nil	Nil
	Treasury Management			
7.	Operational Boundary (£)	£378,936,000	£376,916,000	£384,904,000
8.	Authorised Limit (£)	£397,900,000	£395,800,000	£404,000,100
9.	Fixed Rate Exposure Limit (£)	£376,699,000	£373,458,000	£380,254,000
10	Variable Rate Exposure Limit (£)	£10,000,000	£10,000,000	£10,000,000
11	The Council will continue with its policy to borrow only at fixed rates of interest			
12	The Council determines the following maturity structure for new borrowing in 2005/06 :-			
		Upper limit	Lower limit	
		%	%	
	Under 12 months	0	0	
	12 months and within 24 months	0	0	
	24 months and within 5 years	50	0	
	5 years and within 10 years	50	0	
	10 years and above	100	50	
13	The Council will not invest for periods of longer than 364 days			