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 2007/08. The main requirements are as follows: -

- To determine estimates of capital expenditure for the forthcoming year and the two years thereafter (See Table 1) and resources (See Table 2)
- 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
- Service Objectives, e.g. strategic planning for the authority
- Practicality, e.g. achievability of the forward plan.

The contents of this report are consistent with the revenue budget report for 2007/08 to 2009/10.

2. Determination of estimates of capital expenditure 2007/08 to 2009/10

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

Table 1. (Estimates of capital expenditure)

	Total	2006/07	2007/08	2008/09	2009/10
	£000s	£000s	£000s	£000s	£000s
Programme reported to Cabinet 16th Nov 2006	299,463.5	117,721.2	93,484.2	58,295.4	29,962.7
Changes	43,554.4	-6,385.7	15,996.4	16,762.7	17,181.0
Programme now estimated	**343,017.9**	**111,335.5**	**109,480.6**	**75,058.1**	**47,143.7**
Comprising:					
Non HRA services	249,217.9	77,835.5	82,580.6	57,758.1	31,043.7
HRA Services	93,800.0	33,500.0	26,900.0	17,300.0	16,100.0
Total	**343,017.9**	**111,335.5**	**109,480.6**	**75,058.1**	**47,143.7**

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

- The 3 year capital programme up to 2008/09 plus commitments into 2009/10.
- The capital allocations announced by central government for housing, transport, Adult Services and CYPS. 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 2007/08 is set at £26.9 million. For 2008/09 and 2009/10 it has been estimated at £17.3 million and £16.1 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 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 are the aggregation of certain figures in the latest balance sheet, in this case 31st March 2006. 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 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 2008/09, whilst others have not. Indications of allocations have been given for the Local Transport Plan for 2009/10.
  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 an approved boiler replacement scheme, approved Adult Services revenue saving schemes, projected costs of Leigh Sports Village (LSV) Pool (£3m), and funding of the delay between LSV construction costs and receipt of grant (£12m). Provision has also been made for the prudential borrowing to fund the Westwood Project prior to the capital receipt from the site materialising.

- Capital receipts from Right to Buy sales have been re-assessed by the ALMO. The programme now reported assumes an increase in the period to March 31st 2010 of a further £0.5 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 £9.9 million, £2.5m for each of the years 2006/07 to 2008/09 and then a further £2.4 million for the year 2009/10. 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 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.

- Grants and external contributions have been assessed to match expenditure under the various regimes.

Table 2. (Resourcing the capital programme)

	2006/07	2007/08	2008/09	2009/10
	£'000	£'000	£'000	£'000
Total Spend requiring funding	**111,335.5**	**109,480.6**	**75,058.1**	**47,143.7**
Borrowing – supported	8,086.8	9,471.2	5,282.0	5,567.0
Borrowing – unsupported	13,656.9	-3,969.3	-117.0	933.0
External contributions	4,931.7	5,190.0	3,159.1	1,546.0
Capital receipts	27,473.7	23,351.8	9,050.0	5,050.0
Government Grants	23,022.3	47,147.1	40,857.2	16,980.7
Operating leases	1,334.1	1,951.0	667.0	667.0
Direct Revenue funding – General Fund	639.6	464.2	0	0
Direct Revenue funding - HRA	18,100.0	9,700.0	2,600.0	1,600.0
HRA Resources – Major Repairs Allowance	13,600.0	15,900.0	13,700.0	13,800.0
Sub total	**110,845.1**	**109,206.0**	**75,198.3**	**46,143.7**
Net Surplus / (deficit)				
In year position	(490.4)	(274.6)	140.2	(1,000.0)
Cumulative	(490.4)	(765.0)	(624.8)	(1,624.8)

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 31st March 2007	217,595	213,381	430,976
Change in 2007/08	0	29,242	29,242
Estimated at 31st March 2008	217,595	242,623	460,218
Change in 2008/09	0	-4,945	-4,945
Estimated at 31st March 2009	217,595	237,678	455,273
Change in 2009/10	-4,352	-5,650	-10,002
Estimated at 31st March 2010	213,243	232,028	445,271

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 2007/08, 2008/09 and 2009/10 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 below sets out the calculations

Table 4. (Ratio of capital financing costs to revenue streams)

	2007/08	2008/09	2009/10
Non - HRA services			
Estimated financing costs (£'000)	21,993	21,509	20,977
Estimated net revenue stream (£'000)	217,933	224,304	230,873
Ratio of financing costs to net revenue (%)	**10.09%**	**9.59%**	**9.09%**

HRA	**2007/08**	**2008/09**	**2009/10**
Estimated financing costs (£'000)	15,044	19,095	18,714
Estimated net revenue stream (£'000)	68,800	66,600	65,900
Ratio of financing costs to net revenue (%)	**21.87%**	**28.67%**	**28.40%**

In addition, the Council is required to show the incremental impact of capital investment decisions on the Council Tax and housing rents. For the purpose 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)

		2007/08	2008/09	2009/10
Non - HRA services				
Estimated budget requirement with capital programme at estimated levels for 2007/08 to 2009/10 (£'000)	A	217,933	224,304	230,873
Estimated budget requirement with capital programme estimates excluding unsupported borrowing. (£'000)	B	215,276	221,936	228,579
Effect on budget requirement of removing unsupported borrowing and other revenue costs (£'000)	A-B	2,657	2,368	2,294
Cumulative effect on Council Tax (reduction) (£.p)		28.06	-3.05	-0.77
Year on year effect on Council Tax (reduction) (£.p)		28.06	25.01	24.24

HRA		2007/08	2008/09	2009/10
Estimated amount to be met by income from rents etc with capital programme at estimated levels for 2007/08 to 2009/10 (£'000)	A	68,800	66,600	65,900
Estimated amount to be met by income from rents etc with capital programme estimates excluding unsupported borrowing (£'000)	B	68,800	66,600	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 it's external debt. External debt refers to borrowing and other long-term liabilities.

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 2007 is within the approved operational boundary identified in the Prudential report to Cabinet on 16th February 2006.

I have set out in Table 6, the calculation of the operational boundary for the years 2007/08 to 2009/10.

Table 6. (The Operational Boundary)

	Borrowing	Other Long Term Liabilities	Total External Debt
	£'000	£'000	£'000
For 2007/08			
Amounts currently outstanding	386,666	569	387,235
2007/08 cash flows			
Replacement of loans due for repayment	753		753
Use of surplus capital resources at 31.3.07	464		464
Capital Financing requirement 2007/08	6,102		6,102
Revenue set aside (Minimum Revenue Provision etc.)	-11,073	-270	-11,343
Estimated operational boundary at 31.3.2008	**382,912**	**299**	**383,211**
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	5,165		5,165
Revenue set aside (Minimum Revenue Provision etc.)	-15,195	-299	-15,494
Estimated operational boundary at 31.3.2009	**383,631**	**0**	**383,631**
2009/10 cash flows			
Replacement of loans due for repayment	770		770
Use of surplus capital resources at 31.3.09	0		0
Capital Financing requirement 2009/10	6,500		6,500
Revenue set aside (Minimum Revenue Provision etc.)	-14,854		-14,854
Estimated operational boundary at 31.3.2010	**376,047**	**0**	**376,047**

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 should 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 2007/08	402.1	0.3	402.4
For 2008/09	402.8	0	402.8
For 2009/10	394.8	0	394.8

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 purpose 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)

	2007/08	2008/09	2009/10
	£'000	£'000	£'000
Fixed rate exposure			
Estimated fixed rate borrowing (at operational boundary)	382,912	383,631	376,047
Less :- value of investments held at fixed rates	0	0	0
Upper limit on fixed rate exposure	382,912	383,631	376,047
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 it's financial commitments and obligations to those companies in its application of the code.

In the last Prudential Report, it was identified that the Wigan Metropolitan Development Company, a controlled company, had external borrowings of £183,320 which were paid 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. However, it is not currently anticipated that there will be external borrowings during the next 12 months.

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 the table below: -

Table 10. (Summary of Prudential Indicators)

	Indicator	2007/08	2008/09	2009/10
	Capital Spending			
1	Estimated capital expenditure (£)	£109,480,600	£75,058,100	£47,143,700
2	Estimated capital financing requirement (£)	£460,218,000	£455,273,000	£445,271,000
	Capital Financing Ratios			
3	Non HRA Services - estimated ratios of capital financing costs to net revenue streams (%age)	10.09%	9.59%	9.09%
4	HRA Services - estimated ratios of capital financing costs to net revenue streams (%age)	21.87%	28.67%	28.40%
	Impact on Revenue			
5	Incremental impact of Capital Expenditure Decisions on Council Tax (£.p)	£28.06	£25.01	£24.24
6	Incremental impact of Capital Expenditure Decisions on Council House Rents (£.p)	Nil	Nil	Nil
	Treasury Management			
7	Operational Boundary (£)	£383,211,000	£383,631,000	£376,047,000
8	Authorised Limit (£)	£402,400,000	£402,800,000	£394,800,000
9	Fixed Rate Exposure Limit (£)	£382,912,000	£383,631,000	£376,047,000
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 2007/08 :-			
		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			