

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 2008/09. The main requirements are as follows: -

- To determine estimates of capital expenditure and resources for the forthcoming year and the two years thereafter (See Table 1 and 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 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 2008/09 to 2010/11.

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2. Determination of estimates of capital expenditure 2008/09 to 2010/11

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	2007/08	2008/09	2009/10	2010/11
	£000s	£000s	£000s	£000s	£000s
Programme reported to Cabinet 7 th Feb 2008	378,236.7	107,121.6	107,199.3	87,125.3	76,790.5
Changes	2,206.0	154.0	3,722.0	3,372.0	-5,042.0
Programme now estimated	380,442.7	107,275.6	110,921.3	90,497.3	71,748.5
Comprising:					
Non HRA services	298,042.7	80,975.6	89,521.3	69,897.3	57,648.5
HRA Services	82,400.0	26,300.0	21,400.0	20,600.0	14,100.0
Total	380,442.7	107,275.6	110,921.3	90,497.3	71,748.5

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

- The 3 year capital programme up to 2010/11.
- The capital allocations for Transport announced by central government and estimated figures for Housing, 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 settlement details identified in the Local Transport Plan Settlement are shown at Appendix 1 in this report.
- The HRA capital programme for 2008/09 is set at £21.4 million. For 2009/10 and 2010/11 it has been estimated at £20.6 million and £14.1 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 was reported to Cabinet on 7th February 2008, and amendments in the form of cost changes and re-phasing to future years incorporated.

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- The introduction of projects assumed to be approved by Cabinet in line with the Capital Appraisal Report considered earlier. This process is the culmination of agreeing projects in line with the Council's Capital Strategy. This translates the Council's Strategic Objectives into capital investment.

3. Determination of the capital financing requirement

The Prudential Code requires that estimates of the capital financing requirement should be produced. This is 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 2007. 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).
- It is also reduced by any voluntary repayment of debt.

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 to 2010/11, whilst others have not. Indications of allocations have been given for the Local Transport Plan for 2010/11. 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, approved Adult Services revenue saving schemes, projected costs of Leigh Sports Village (LSV) Pool and funding of the delay between LSV construction costs and receipt of grant. Provision has also been made for the prudential borrowing to fund the Westwood Project prior to the capital receipt from the site materialising.
- It has been agreed with the Director of Legal and Property Services that the land disposal programme will generate receipts in the region of £7.5 million.
- It is estimated that the usable proportion of Right to Buy receipts for 2008/09 to 2010/11 will be in the region of £6.9 million.
- The HRA programme will be funded by a combination of the Major Repairs Allowance and the HRA's own resources.

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- That current budget for operating leases may be utilised to finance prudential borrowing if this is considered to be the best option.
- Grants and external contributions have been assessed to match expenditure under the various regimes.

Table 2. (Resourcing the capital programme)

	2007/08	2008/09	2009/10	2010/11
	£'000	£'000	£'000	£'000
Total Spend requiring funding	107,275.6	110,921.3	90,497.3	71,748.5
Borrowing – supported	7,050.7	10,720.0	9,420.1	8,774.3
Borrowing – unsupported	-388.7	190.3	-6,351.4	1,651.0
External contributions	5,421.3	7,393.3	3,391.4	1,859.0
Capital receipts	34,767.5	21,663.8	16,423.0	6,095.3
Government Grants	32,270.2	46,706.2	45,578.4	37,819.9
Operating leases	3,359.3	1,350.0	1,350.0	1,349.0
Direct Revenue funding – General Fund	1,036.3	1,250.4	0	0
Direct Revenue funding - HRA	8,349.3	6,800.0	6,000.0	0
HRA Resources – Major Repairs Allowance	16,300.0	13,600.0	13,900.0	13,500.0
Sub total	108,165.9	109,674.0	89,711.5	71,048.5
Net Surplus / (deficit)				
In year position	890.3	-1,247.3	-785.8	-700.0
Cumulative	890.3	-357.0	-1,142.8	-1,842.8

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 31 st March 2008	217,595	201,117	418,712
Change in 2008/09	0	-279	-279
Estimated at 31 st March 2009	217,595	200,838	418,433
Change in 2009/10	0	-7,501	-7,501
Estimated at 31 st March 2010	217,595	193,337	410,932
Change in 2010/11	-4,352	155	-4,197
Estimated at 31 st March 2011	213,243	193,492	406,735

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 2008/09, 2009/10 and 2010/11 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 Income and Expenditure Account for expenditure to be met from government grants and local taxpayers. Assumed to equate to the budget requirement.
- For the HRA - The amount met from rents and government grants.

Table 4 below sets out the calculations.

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

	2008/09	2009/10	2010/11
Non - HRA services			
Estimated financing costs (£'000)	19,368	18,570	18,072
Estimated net revenue stream (£'000)	233,250	239,927	246,150
Ratio of financing costs to net revenue (%)	8.30%	7.74%	7.34%

HRA	2008/09	2009/10	2010/11
Estimated financing costs (£'000)	15,323	15,057	19,104
Estimated net revenue stream (£'000)	65,700	67,400	69,100
Ratio of financing costs to net revenue (%)	23.32%	22.34%	27.65%

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)

		2008/09	2009/10	2010/11
Non - HRA services				
Estimated budget requirement with capital programme at estimated levels (£'000)	A	233,250	239,927	246,150
Estimated budget requirement with capital programme estimates excluding unsupported borrowing (£'000)	B	230,500	237,547	244,244
Effect on budget requirement of removing unsupported borrowing and other revenue costs (£'000)	A-B	2,750	2,380	1,906
Cumulative effect on Council Tax [at Band D] (reduction) (£.p)		0.23	-3.62	-8.81
Effect on Council Tax [at Band D] (reduction) (£.p)		28.72	24.87	19.90

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		2008/09	2009/10	2010/11
HRA				
Estimated amount to be met by income from rents etc with capital programme at estimated levels (£'000) – per Cabinet Report 7 th Feb 2008	A	66,000	68,600	71,300
Estimated amount to be met by income from rents etc with capital programme estimates excluding unsupported borrowing (£'000)	B	66,000	68,600	71,300
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
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.

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 2008 is within the approved operational boundary identified in the Prudential report to Cabinet on 21st February 2008.

I have set out in Table 6, the calculation of the operational boundary for the years 2008/09 to 2010/11.

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Table 6. (The Operational Boundary)

	Borrowing	Other Long Term Liabilities	Total External Debt
	£'000	£'000	£'000
For 2008/09			
Amounts currently outstanding	364,611	299	364,910
2008/09 cash flows			
Replacement of loans due for repayment	10,749		10,749
Use of surplus capital resources at 31.3.08	1,250		1,250
Change in Capital Financing requirement 2008/09	10,622		10,622
Revenue set aside (Minimum Revenue Provision etc)	-10,603	-299	-10,902
Estimated operational boundary at 31.3.2009	376,629	0	376,629
2009/10 cash flows			
Replacement of loans due for repayment	770		770
Use of surplus capital resources at 31.3.09	0		0
Change in Capital Financing requirement 2009/10	3,069		3,069
Revenue set aside (Minimum Revenue Provision etc)	-10,570	0	-10,570
Estimated operational boundary at 31.3.2010	369,898	0	369,898
2010/11 cash flows			
Replacement of loans due for repayment	9,644		9,644
Use of surplus capital resources at 31.3.10	0		0
Change in Capital Financing requirement 2010/11	10,425		10,425
Revenue set aside (Minimum Revenue Provision etc)	-14,622		-14,622
Estimated operational boundary at 31.3.2011	375,345	0	375,345

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 2008/09	395.5	0	395.5
For 2009/10	388.4	0	388.4
For 2010/11	394.1	0	394.1

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.

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)

	2008/09	2009/10	2010/11
	£'000	£'000	£'000
Fixed rate exposure			
Estimated fixed rate borrowing (at operational boundary)	376,629	369,898	375,345
Less :- value of investments held at fixed rates	0	0	0
Upper limit on fixed rate exposure	376,639	369,898	375,345
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)

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

The Treasury Management Policy seeks to limit maturing loans to no more than 10% in any year. To assist in this objective there must be flexibility over the repayment periods selected for new borrowing. 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: -

- At least 50% of all new borrowing 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.

No borrowings are expected by any controlled companies.

8. Recommendations

The various prudential indicator requirements contained within this report are summarised in Table 10.

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

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Table 10. (Summary of Prudential Indicators)

	Indicator	2008/09	2009/10	2010/11
	Capital Spending			
1	Estimated capital expenditure (£)	£110,921,300	£90,497,300	£71,748,500
2	Estimated capital financing requirement (£)	£418,433,000	£410,932,000	£406,735,000
	Capital Financing Ratios			
3	Non HRA Services - estimated ratios of capital financing costs to net revenue streams (%age)	8.30%	7.74%	7.34%
4	HRA Services - estimated ratios of capital financing costs to net revenue streams (%age)	23.32%	22.34%	27.65%
	Impact on Revenue			
5	Annual impact of Capital Expenditure Decisions on Council Tax (£.p)	£28.72	£24.87	£19.90
6	Incremental impact of Capital Expenditure Decisions on Council House Rents (£.p)	Nil	Nil	Nil
	Treasury Management			
7	Operational Boundary (£)	£376,629,000	£369,898,000	£375,345,000
8	Authorised Limit (£)	£395,500,000	£388,400,000	£394,100,000
9	Fixed Rate Exposure Limit (£)	£376,629,000	£369,898,000	£375,345,000
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 2008/09 :-			
		Lower limit	Upper limit	
		%	%	
	10 years and above	50	100	
	5 years and within 10 years	0	50	
	24 months and within 5 years	0	50	
	12 months and within 24 months	0	0	
	Under 12 months	0	0	
13	The Council will not invest for periods of longer than 364 days			