

PRUDENTIAL INDICATORS FOR CAPITAL FINANCE

Purpose

1. To outline the prudential indicators and to suggest how expenditure will be financed by borrowing in an affordable, prudent and sustainable way.

Information and Advice

2. The Local Government Act 2003 enables local authorities to determine their programmes for capital investment and associated borrowing requirements, provided they have regard to the Prudential Code for Capital Finance in Local Authorities developed by CIPFA and also take advice from the Section 151 Officer.
3. The Executive Summary of the Code states that “The framework established by the Prudential Code should support local strategic planning, local asset management planning and proper option appraisal. 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. In exceptional cases, the Prudential Code should provide a framework which will demonstrate that there is a danger of not ensuring this, so that the local authority concerned can take timely remedial action.”
4. The Code sets out a number of prudential indicators designed to support and record local decision making and it is the duty of the Service Director – Finance, Procurement and Improvement (the Council’s Section 151 Officer) to ensure that this information is available to Members when they take decisions on the County Council’s capital expenditure plans and annual budget. Key issues to be considered are:
 - Affordability (e.g. implications for Council Tax)
 - Prudence and sustainability (e.g. implications for external borrowing and whole life costing)
 - Value for money (e.g. option appraisal)
 - Stewardship of assets (e.g. asset management planning)
 - Service objectives (e.g. alignment with the Council’s Strategic Plan)
 - Practicality (e.g. whether the capital plans are achievable).

Prudential Indicators**Affordability**

5. The Code requires the Council to be aware of the impact of financing capital expenditure on its overall revenue expenditure position and on its Council Tax requirements.
6. The costs of financing capital expenditure are:
 - Interest payable to external lenders less interest earned on investments; and
 - Amounts set aside for repayments of amounts borrowed (including repayments of amounts relating to PFI schemes and other finance lease liabilities).

The relevant figures from the 2014/15 Accounts are as follows.

Table F1 – 2014/15 Capital Financing Costs and Net Revenue Stream

Capital Financing Costs	£m
Interest Payable (incl. PFI/Finance Leases)	32.907
Interest and Investment Income	(0.430)
Repayment of Previous Years' Borrowing	3.049
Repayment of PFI/Finance Lease Liabilities	4.026
Other Amounts Set Aside for Repaying Debt	20.586
Total Capital Financing Costs	60.138
Net Revenue Stream	568.886

7. The Capital Financing Costs as a proportion of Net Revenue Stream for 2014/15 and future years are shown in the table below:

Table F2 – Capital Financing Costs as a Proportion of Net Revenue Stream

Capital Financing Costs as a proportion of Net Revenue Stream		
Actual	2014/15	10.6%
Estimates	2015/16	11.6%
	2016/17	9.3%
	2017/18	10.0%
	2018/19	9.9%
	2019/20	10.2%

8. Despite a reducing Net Revenue Stream over the medium term, the estimated proportions fall in 2016/17 as a result of lower Minimum Revenue Provision (MRP) charges following the MRP Review and associated changes to the MRP methodology. The proportion of capital financing costs to net revenue stream will be kept under review.
9. The Prudential Code requires local authorities to make reasonable estimates of the total capital expenditure that it plans to incur in the forthcoming financial year and at least the following two financial years. These indicators, together with anticipated sources of finance, are as follows.

Table F3 – Estimates of Capital Expenditure

	2016/17 £m	2017/18 £m	2018/19 £m	2019/20 £m
Capital Expenditure	112.305	56.366	45.992	38.030
Funded From:				
Borrowing	54.723	23.785	24.400	16.438
Grants and Contributions	56.877	31.911	20.922	20.922
Revenue / Reserves	0.705	0.670	0.670	0.670
Total	112.305	56.366	45.992	38.030

10. The proposed level of borrowing under the Prudential Code for 2016/17 is £54.7m, which is more than previously envisaged because of re-phasing and slippage of expenditure from prior years. This re-phasing does not result in a higher overall level of debt.
11. The Prudential Code requires the impact of financing new borrowing on Council Tax levels to be assessed. The estimated levels of cumulative financing costs of total new borrowing (for both the continuing Capital Programme and the proposed changes to the Capital Programme) in the next four years are shown in the following table.

Table F4 – Estimates of the Incremental Impact on Council Tax of Borrowing for the 2016/17 to 2019/20 Capital Programme

	2016/17 £m	2017/18 £m	2018/19 £m	2019/20 £m
Cumulative Borrowing	54.7	78.5	102.9	119.3
Estimated Financing Costs	0.72	2.92	4.10	5.11
Cumulative Band D Council Tax impact (£/p)	£1.67	£7.35	£11.17	£14.79

12. The Band D Council Tax for 2015/16 was £1,241.14. The forecast theoretical impact of capital financing on Council Tax is an increase of £1.67 or 0.2% in 2016/17.

13. Under the Prudential Code, the County Council is also required to forecast the total budgetary requirements arising specifically from the changes proposed to the Capital Programme in the Budget Report (paragraphs 46 to 53) and to calculate the resulting impact of these capital investment decisions on Council Tax levels.
14. The figures shown below include the impact of proposed capital investments to be made over the period 2016/17 to 2019/20, but exclude the impact of any unquantified ongoing revenue savings that may arise from capital investments and exclude the impact of any scheme re-phasing or changes to the Capital Programme which were approved prior to the date of this report.

Table F5 – Estimates of the Incremental Impact on Council Tax of the new Capital Proposals

	2015/16 £m	2016/17 £m	2017/18 £m	2018/19 £m	2019/20 £m
Cumulative Net Impact of Proposals on Borrowing	0.00	0.00	0.00	0.00	0.00
Estimated Financing Costs of Proposals	0.00	0.00	0.00	0.00	0.00
*Cumulative Band D Council Tax impact (£/p)	£0.00	£0.00	£0.00	£0.00	£0.00

15. Any additions to the capital programme as a result of this report will be funded from external grant, reserves, contingency or revenue resources. As a result there will be no incremental impact on Council Tax.

Prudence and Sustainability

16. One of the features of the Prudential Code arrangements is the need to calculate the Capital Financing Requirement. This figure covers capital expenditure which has not yet been permanently financed through the revenue account. It is derived by consolidating a number of Balance Sheet items as follows.

Table F6 – Capital Financing Requirement 2014/15

	£m
Fixed Assets	1,207
Short-term Assets Held For Sale	5
Capital Adjustment Account	(385)
Revaluation Reserve	(110)
Capital Financing Requirement as at 31/3/14	717

17. The Code states that “In order to ensure that over the medium term net debt will only be for a capital purpose, the local authority should ensure that net debt does not, except in the short term, exceed the total of the capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years.” This is a key indicator of prudence.
18. The Capital Financing Requirement needs to be rolled forward to the estimated position at the end of 2015/16:

Table F7 – Estimated Capital Financing Requirement 2015/16

	£m
Capital Financing Requirement 2014/15	717
Borrowing in 2015/16	49
Additional PFI/Finance Lease Liabilities in 2015/16	4
Repayment of PFI/Finance Lease Liabilities in 2015/16	(5)
Capital Receipts set against previous borrowing in 2015/16	(8)
Other amounts set aside for Repayment of Debt in 2015/16	(19)
Estimated Capital Financing Requirement 2015/16	738

19. The additional Capital Financing Requirements for the next 3 years are:

Table F8 – Estimated Capital Financing Requirements 2016/17 - 2018/19

	2016/17 £m	2017/18 £m	2018/19 £m
New Borrowing	55	24	24
Additional PFI/Finance Lease Liabilities	3	6	-
Repayment of PFI/Finance Lease Liabilities	(3)	(3)	(4)
Capital Receipts set against previous borrowing	(15)	(14)	(10)
Other amounts set aside for Repayment of Debt	-	-	-
Capital Financing Requirement Net Additions	40	12	10
Estimated Capital Financing Requirement	778	790	800

20. As such there is a requirement to ensure that net debt (the sum of borrowing and other long-term liabilities, net of investments) in 2016/17 does not, except in the short term, exceed £800m (i.e. the estimated CFR for 2018/19).
21. The Local Government Act 2003 requires the County Council to set two borrowing limits for next year and the following two years with respect to external borrowing:-
22. Operational Boundary – operational boundaries have to be set for both borrowing and long term liabilities. This measure encompasses all borrowing and is used in-year as a tool for monitoring the Council's prudent borrowing requirements. The operational boundary is calculated

by taking account of existing borrowing and long term liabilities, planned new borrowing, net change in long term liabilities and any amounts set aside for repayment of debt.

23. Authorised Limit – this higher measure, is the upper limit on the level of gross indebtedness which must not be breached without County Council approval. If it appears that the Authorised Limit might be breached, the Service Director – Finance, Procurement and Improvement has a duty to report this to the County Council for appropriate action to be taken.
24. The Operational Boundary for external debt for the next three years is built up from the existing level of external borrowing, which was £416m, and the level of relevant liabilities (including finance lease liabilities), which was £125m, on the Balance Sheet at 31 March 2015.
25. These figures can be rolled forward to provide the proposed Operational Boundaries for 2016/17 and subsequent years.

Table F9 – Operational Boundaries 2016/17 – 2018/19

	Borrowing £m	Other Long-Term Liabilities £m	TOTAL £m
External borrowing at 31 March 2015	416	-	416
Other Long-Term Liabilities at 31 March 2015	-	125	125
Net new borrowing in 2015/16	9	-	9
Net change in PFI/finance lease liabilities	-	-	-
Estimated external borrowing at 31 March 2016	425	125	550
Capital expenditure financed by borrowing 2016/17	55	-	55
Amounts set aside for repayment of debt	(15)	-	(15)
Net change in PFI/finance lease liabilities	-	-	-
Contingency for changes in cash flow forecast	37	-	37
Operational Boundary 2016/17	502	125	627
Capital expenditure financed by borrowing 2017/18	24	-	24
Amounts set aside for repayment of debt	(14)	-	(14)
Net change in PFI/finance lease liabilities	-	3	3
Contingency for changes in cash flow forecast	37	-	37
Operational Boundary 2017/18	549	128	677
Capital expenditure financed by borrowing 2018/19	24	-	24
Amounts set aside for repayment of debt	(11)	-	(11)
Net change in PFI/finance lease liabilities	-	(4)	(4)
Contingency for changes in cash flow forecast	37	-	37
Operational Boundary 2018/19	599	124	723

26. The contingency for unforeseen borrowing is available for increases in the Capital Programme that require financing by borrowing.
27. The Authorised Limits should not need to be varied during the year, except for exceptional purposes. It is proposed to add a further £25m to the Operational Boundaries for Borrowing to provide sufficient headroom for events such as unusual cash movements. The proposed Authorised Limits are:

Table F10 – Authorised Limits 2016/17 – 2018/19

	Authorised Limit		
	Borrowing £m	Other Long-Term Liabilities £m	Borrowing and Other Long-Term Liabilities £m
2016/17	527	125	652
2017/18	574	128	702
2018/19	624	124	748

28. Both the Authorised Limits and Operational Boundaries are less than the Capital Financing Requirement because best practice in treasury management means that actual borrowing is below the notional underlying borrowing requirement.
29. The Prudential Code indicator in respect of treasury management is the adoption of the CIPFA Treasury Management Code of Practice. The County Council has formally adopted the code and approves an annual Treasury Management Policy and Strategy. This includes setting the treasury indicators:
 - upper limits for fixed and variable interest rate exposures
 - upper limit for investments over 364 days
 - upper and lower limits for the maturity structure of borrowing.

Value for money – option appraisal

30. The County Council's Capital Programme is driven by the desire to provide high quality, value for money public services. It is monitored by the Corporate Asset Management Group, which is a cross-service group of Officers with a finance, service and property management background. Business cases for proposed new capital schemes are reviewed by this group and presented to Finance and Property Committee.

Stewardship of Assets

31. The Council's Asset Management Plan sets out the condition of its assets and the arrangements for managing these effectively. The

Council's Corporate Property Strategy enhances these arrangements, including increasing the awareness that efficient use of property is an important element of maximising the value obtained from the Council's overall resources.

Service Objectives

32. The option appraisal of proposed capital schemes overseen by the Corporate Asset Management Group considers, amongst other factors, the following:
- How the proposal help achieve the objectives and priorities set out in the Council's Strategic Plan 2014-2018.
 - How the proposal will help achieve objectives set out in Service Delivery Plans.
 - How the proposal meets principles identified in the Redefining Your Council document.
 - The service improvements and other anticipated benefits expected to be delivered from the investment.

Practicality

33. The Capital Programme is monitored throughout the year to ensure that:
- Any slippage on major schemes is identified as soon as possible.
 - Variations to the Capital Programme are reported to Finance and Property Committee on a regular basis.
 - Funding sources are available when required.

Recommendation

34. It is recommended that the Prudential Indicators in Table F11 are approved as part of the 2016/17 budget.

Table F11 – Prudential Indicators 2016/17 – 2018/19

	2016/17	2017/18	2018/19
Estimated capital expenditure	£112.3m	£56.4m	£46.0m
Estimated Capital Financing Requirement	£778m	£790m	£800m
Authorised limit for external debt	£652m	£702m	£748m
Operational boundary for external debt	£627m	£677m	£723m
Financing costs as a % of net revenue stream	9.3%	10.0%	9.9%
Impact of total capital investment on Council Tax (£/p)	£1.67	£7.35	£11.17
Impact of proposed changes to the Capital Programme on Council Tax (£/p)	£0.00	£0.00	£0.00

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