

## **Report of the Service Director – Finance & Procurement**

### **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 and Procurement (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 2013/14 Accounts are as follows.

**Table F1 – 2013/14 Capital Financing Costs and Net Revenue Stream**

<b>Capital Financing Costs</b>	<b>£'m</b>
Interest Payable (incl. PFI/Finance Leases)	32.096
Interest and Investment Income	(0.679)
Repayment of Previous Years' Borrowing	2.680
Repayment of PFI/Finance Lease Liabilities	4.684
Other Amounts Set Aside for Repaying Debt	19.816
<b>Total Capital Financing Costs</b>	<b>58.597</b>

  

<b>Net Revenue Stream</b>	<b>572.720</b>
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7. The Capital Financing Costs as a proportion of Net Revenue Stream for 2013/14 and future years are shown in the table below:

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

<b>Capital Financing Costs as a proportion of Net Revenue Stream</b>		
<b>Actual</b>	2013/14	10.2%
<b>Estimates</b>	2014/15	10.3%
	2015/16	11.4%
	2016/17	13.2%
	2017/18	13.6%
	2018/19	13.1%

8. Much of the variation over time in the above estimated proportions is related to the variation in the levels of capital receipts available to set against the principal of amounts previously borrowed. A further factor is the reducing forecast of Net Revenue Stream. 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 of 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**

	2015/16 £'m	2016/17 £'m	2017/18 £'m	2018/19 £'m
<b>Capital Expenditure</b>	<b>112.039</b>	<b>94.787</b>	<b>45.451</b>	<b>39.792</b>
<b>Funded From:</b>				
Borrowing	55.452	41.044	16.770	20.700
Grants and Contributions	51.829	50.885	27.461	17.922
Revenue / Reserves	4.758	2.858	1.220	1.170
<b>Total</b>	<b>112.039</b>	<b>94.787</b>	<b>45.451</b>	<b>39.792</b>

10. The proposed level of borrowing under the Prudential Code for 2015/16 is £55.5m, 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 2015/16 to 2018/19 Capital Programme**

	2015/16 £'m	2016/17 £'m	2017/18 £'m	2018/19 £'m
Cumulative Borrowing	55.5	96.5	113.3	134.0
Estimated Financing Costs	0.83	3.32	4.64	5.50
<b>Cumulative Band D Council Tax impact (£/p)</b>	<b>£3.55</b>	<b>£14.30</b>	<b>£20.03</b>	<b>£23.72</b>

12. The Band D Council Tax for 2014/15 was £1,216.92. The forecast theoretical impact of capital financing on Council Tax is an increase of £3.55 or 0.3% in 2015/16.
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 39 to 73) 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 2015/16 to 2018/19, 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**

	2014/15 £'m	2015/16 £'m	2016/17 £'m	2017/18 £'m	2018/19 £'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
<b>*Cumulative Band D Council Tax impact (£/p)</b>	<b>£0.00</b>	<b>£0.00</b>	<b>£0.00</b>	<b>£0.00</b>	<b>£0.00</b>

15. Any additions to the capital programme as a result of this report will be funded from external grant, reserves 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 2013/14**

	£'m
Fixed Assets	1,205
Short-term Assets Held For Sale	5
Capital Adjustment Account	(378)
Revaluation Reserve	(115)
<b>Capital Financing Requirement as at 31/3/14</b>	<b>717</b>

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 2014/15:

**Table F7 – Estimated Capital Financing Requirement 2014/15**

	£'m
<b>Capital Financing Requirement 2013/14</b>	<b>717</b>
Borrowing in 2014/15	32
Additional PFI/Finance Lease Liabilities in 2014/15	4
Repayment of PFI/Finance Lease Liabilities in 2014/15	(4)
Capital Receipts set against previous borrowing in 2014/15	(4)
Other amounts set aside for Repayment of Debt in 2014/15	(20)
<b>Estimated Capital Financing Requirement 2014/15</b>	<b>725</b>

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

**Table F8 – Estimated Capital Financing Requirements 2015/16 - 2017/18**

	2015/16 £'m	2016/17 £'m	2017/18 £'m
New Borrowing	55	41	17
Additional PFI/Finance Lease Liabilities	5	2	-
Repayment of PFI/Finance Lease Liabilities	(4)	(5)	(4)
Capital Receipts set against previous borrowing	(7)	(13)	(14)
Other amounts set aside for Repayment of Debt	(20)	(20)	(21)
<b>Capital Financing Requirement Net Additions</b>	<b>29</b>	<b>5</b>	<b>(22)</b>

<b>Estimated Capital Financing Requirement</b>	<b>754</b>	<b>759</b>	<b>737</b>
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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 2015/16 does not, except in the short term, exceed £759m (i.e. the estimated CFR for 2016/17).
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.

## APPENDIX F

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 and Procurement 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 £358m, and the level of relevant liabilities (including finance lease liabilities), which was £127m, on the Balance Sheet at 31 March 2014.
25. These figures can be rolled forward to provide the proposed Operational Boundaries for 2015/16 and subsequent years.

**Table F9 – Operational Boundaries 2015/16 – 2017/18**

	<b>Borrowing £'m</b>	<b>Other Long-Term Liabilities £'m</b>	<b>TOTAL £'m</b>
External borrowing at 31 March 2014	358		358
Other Long-Term Liabilities at 31 March 2014		127	127
Net new borrowing in 2014/15	40		40
Net change in PFI/finance lease liabilities			
<b>Estimated external borrowing at 31 March 2015</b>	<b>398</b>	<b>127</b>	<b>525</b>
Capital expenditure financed by borrowing 2015/16	55		55
Amounts set aside for repayment of debt	(26)		(26)
Net change in PFI/finance lease liabilities		-	-
Contingency for changes in cash flow forecast	33		33
<b>Operational Boundary 2015/16</b>	<b>460</b>	<b>127</b>	<b>587</b>
Capital expenditure financed by borrowing 2016/17	41		41
Amounts set aside for repayment of debt	(34)		(34)
Net change in PFI/finance lease liabilities		(2)	(2)
Contingency for changes in cash flow forecast	33		33
<b>Operational Boundary 2016/17</b>	<b>500</b>	<b>125</b>	<b>625</b>
Capital expenditure financed by borrowing 2017/18	17		17
Amounts set aside for repayment of debt	(35)		(35)
Net change in PFI/finance lease liabilities		(4)	(4)
Contingency for changes in cash flow forecast	33		33
<b>Operational Boundary 2017/18</b>	<b>515</b>	<b>121</b>	<b>636</b>

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 2015/16 – 2017/18**

	Authorised Limit		
	Borrowing £'m	Other Long-Term Liabilities £'m	Borrowing and Other Long-Term Liabilities £'m
<b>2015/16</b>	485	127	612
<b>2016/17</b>	525	125	650
<b>2017/18</b>	540	121	661

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 J11 are approved as part of the 2015/16 budget.

**Table F11 – Prudential Indicators 2015/16 – 2017/18**

	<b>2015/16</b>	<b>2016/17</b>	<b>2017/18</b>
Estimated capital expenditure	£112.039m	£94.787m	£45.451m
Estimated Capital financing requirement	£754m	£759m	£737m
Authorised limit for external debt	£612m	£650m	£661m
Operational boundary for external debt	£587m	£625m	£636m
Financing costs as a % of net revenue stream	11.4%	13.2%	13.6%
Impact of total capital investment on Council Tax (£/p)	£3.55	£14.30	£20.03
Impact of proposed changes to the Capital Programme on Council Tax (£/p)	£0.00	£0.00	£0.00

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