REPORT OF THE SERVICE DIRECTOR – FINANCE, PROCUREMENT & IMPROVEMENT

MONITORING OF 2016/17 PRUDENTIAL INDICATORS

To provide an update the County Council's current position in terms of capital expenditure, external debt, financing costs as a percentage of net revenue stream and the capital financing requirement relative to the Prudential Code indicators identified in the 2016/17 budget report.

Background

The Prudential Code for Capital Finance in Local Authorities was developed by CIPFA as a professional code of practice to support local authorities in determining their programmes for capital investment. Local authorities are required by regulation to have regard to the Prudential Code under Part 1 of the Local Government Act 2003. Individual local authorities are responsible for deciding the level of their affordable borrowing, having regard to the Prudential Code. The Executive Summary of the Code states that "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 particular, the Prudential Code requires the Council to be aware of the impact of financing capital expenditure on its overall revenue expenditure position. The costs of financing additional capital expenditure are the interest payable to external lenders and the amounts set aside to reduce the level of borrowing. In deciding whether or not borrowing is affordable, prudent and sustainable, the most important consideration is whether, over the term of the borrowing, these costs can be met from the revenue budget without unacceptable consequences.

Prudential Indicators

Monitoring Requirements

Under the Prudential Code, an authority is required to establish indicators that are sufficiently robust and credible for it to be able to use them to form a judgement as to whether its proposed capital investment is affordable, prudent and sustainable. The Prudential Code requires that the prudential indicators are monitored regularly throughout the year and that the actual values of some of them are reported at year end.

This report is concerned only with prudential indicators relating to capital investment. indicators.

Overview of Prudential Indicators

The following prudential indicators, whose actual values must be reported at year end, relate to affordability and prudence.

Estimate of capital expenditure
In any year, the level of capital expenditure is likely to deviate from the estimate in the budget report as a result of new additions to the Capital Programme, cancellations of schemes, and slippage, acceleration and changing specifications of projects. The Capital Programme is monitored on a monthly basis and variations to the Capital Programme are reported to Finance and Property Committee on a regular basis.

Estimate of the capital financing requirement (CFR)
The capital financing requirement is a measure of the Authority's underlying need to borrow for capital purposes. This relates to capital expenditure which has not yet been financed by capital receipts, capital grants or contributions from revenue income. This is not the same as external debt since the Authority manages its position in terms of borrowings and investments in accordance with its integrated treasury management strategy and practices. For example, rather than borrowing from an external body, the Authority may judge it prudent to make use of cash that it has already invested for long-term purposes, such as reserves, for 'internal borrowing'. This means that there is no immediate link between the need to borrow to pay for capital spending and the level of external borrowing.

In order to ensure that, over the medium term, net borrowing 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 for the current and next two financial years. This is a key indicator of prudence.

External debt
External debt includes gross borrowing and other long-term liabilities.

Operational boundary for external debt
The operational boundary is the estimated maximum level of external debt in the most likely (i.e. prudent, but not worst-case) scenario. The operational boundary is a key management tool for in-year monitoring. It will probably not be significant if the external debt temporarily breaches the operational boundary on occasions due to variations in cash flow. However, a sustained or regular trend above the operational boundary would be significant and would require investigation and possible action (e.g. to ensure that borrowing, other than temporary borrowing, is not undertaken for purposes other than funding approved capital expenditure).

Authorised limit for external debt
The authorised limit is the intended absolute limit for external debt and exceeds the operational boundary by an amount that provides sufficient headroom for events such as unusual cash movements. 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.

Financing costs as a percentage of net revenue stream
The Prudential Code requires the Council to be aware of the impact of financing capital expenditure on its overall revenue expenditure position. The relevant indicator is the financing costs of capital expenditure expressed as a percentage of the net revenue stream, where:

- the costs of financing capital expenditure are interest payable to external lenders less interest earned on investments plus amounts set aside to reduce the level of borrowing; and
- the net revenue stream is the amount of the revenue budget to be met from government grants and local taxpayers.

Prudential Indicators: Monitoring against 2016/17 Budget

The following table shows monitoring against those indicators that were approved for 2016/17 in the Budget Report to Council in February 2016.

<table>
<tr><th>Indicator</th><th>Comments</th></tr>
<tr><td>Estimated capital expenditure
(excluding Schools Devolved Formula Capital and schools' capital expenditure funded from their own revenue budget)

2016/17 Budget: £112.305m
2016/17 Actual: £74.931m</td><td>Current capital programme is £37.374m less than anticipated, as explained in the table:

<table>
<tr><th>Reason</th><th>£m</th></tr>
<tr><td>Slippage from 2015/16 to 2016/17</td><td>20.838</td></tr>
<tr><td>Re-phasing/slippage approved in-year</td><td>(43,959)</td></tr>
<tr><td>Other net variations</td><td>(14,253)</td></tr>
<tr><td>TOTAL</td><td>(37.374)</td></tr>
</table></td></tr>
<tr><td>Estimated capital financing requirement
(taking into account PFI Finance Lease Liabilities)

2016/17 Budget: £778m

2016/17 Actual: £717m</td><td>The actual level of the capital financing requirement was £61m less than the indicator, as explained in the table:

<table>
<tr><th>Reason</th><th>£m</th></tr>
<tr><td>Borrowing below budgeted level in 2015/16 (primarily due to slippage of expenditure funded by borrowing)</td><td>(23)</td></tr>
<tr><td>MRP repayments and voluntary contributions in 2016/17 (from capital receipts, revenue and reserves) lower than forecast</td><td>8</td></tr>
<tr><td>Borrowing below budgeted level in 2016/17 (primarily due to slippage of expenditure funded by borrowing)</td><td>(46)</td></tr>
<tr><td>TOTAL</td><td>(61)</td></tr>
</table></td></tr>
<tr><td>External debt
(incl. PFI Finance Lease Liabilities)

Authorised limit for borrowing: £527m
Authorised limit for other long-term liabilities: £125m
Authorised limit for external debt: £652m

Operational boundary for borrowing: £502m
Operational boundary for other long-term liabilities: £125m
Operational boundary for external debt: £627m

Actual borrowing: £447m
Actual other long-term liabilities: £125m
Total actual debt at 31/03/17: £572m</td><td>The actual level of external debt was below both the authorised limit of £612m and the operational boundary of £587m throughout 2016/17.</td></tr>
</table>

Indicator	Comments
Financing costs as a percentage of net revenue stream (incl. impact of PFI Finance Lease Liabilities) 2016/17 Budget: 9.3% 2016/17 Actual: 8.0%	The total of actual financing costs as a percentage of net revenue stream was below the budgeted figure as a result of lower than expected capital receipts income in 2016/17. Also, the net revenue stream was higher than forecast mainly because capital grants and contributions were above estimates.

Summary

The Prudential Code indicators will continue to be monitored and reported against budgeted figures.