

## **Actual Treasury Position and Prudential Indicators 2020/21**

### **1. Introduction**

The Local Government Act 2003 introduced a new system of capital controls for Local Authorities. The key principle of the system of controls is that local authorities have the freedom to borrow for capital investment purposes providing that they can demonstrate that borrowing is affordable, sustainable and prudent.

The Act requires all local authorities to have regard to the Chartered Institute of Public Finance and Accountancy (CIPFA) Prudential Code. The Code is a professional code that sets out a framework for self-regulation of capital spending. It sets out the approach that all authorities must take in undertaking integrated medium term revenue and capital budget planning and a set of indicators that must be considered and/or approved in order to demonstrate that annual capital investment and treasury management decisions are affordable, sustainable and prudent.

Members' involvement through the process is essential in order that the Council can demonstrate that capital expenditure plans are affordable, external borrowing is prudent and sustainable and that treasury decisions are taken in accordance with good practice. The structure and content of the treasury management report complies with the requirements of the Code for 2020/21.

To facilitate the decision making process and support capital investment decisions the Prudential Code requires the Council to agree and monitor a minimum number of prudential indicators. These indicators are mandatory, but can be supplemented with local indicators if this aids interpretation and many will cover three years forward. The indicators cover affordability, prudence, capital expenditure, external debt and treasury management. These indicators will also form the basis of in year monitoring and reporting.

The indicators are purely for internal use by the Council and are not to be used as comparators between councils, as any comparisons will not take account of local factors and so will be meaningless. In addition, the indicators should not be taken individually; rather the benefit from monitoring will arise from following the movement in indicators over time and the year on year changes.

This annexe provides a commentary on each prudential indicator relevant to the Council and sets out the actual 2020/21 prudential indicators for approval as part of the Council's requirement to comply with the Prudential Code.

### **2. Affordability Prudential Indicator**

Prudential indicators are required to assess the affordability of the capital investment plans. These indicators provide an indication of the impact of the capital investment plans on the overall Council finances.

#### Actual and Estimates of the Ratio of Financing Costs to Net Revenue Stream

This is an indicator of affordability and highlights the revenue implications of capital expenditure by identifying the proportion of the net revenue budget required to meet financing costs, net of investment income.

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<b>Ratio of Financing Costs to Net Revenue Streams</b>	<b>2019/20 Actual</b>	<b>2020/21 Estimated</b>	<b>2020/21 Actual</b>
General Fund	13%	13%	15%

The actual ratios above reflect the net cost of borrowing after allowing for investment income. In practice, the financing costs are fully funded by further income generated from both the Council's and Epsom & Ewell Property Investment Company's investment property acquisitions.

### **3. Capital Expenditure and the Capital Financing Requirement**

The Prudential Code requires the calculation of the Council's Capital Financing Requirement (CFR). This figure represents the Council's underlying need to borrow for capital purposes. The year on year change in CFR is influenced by the capital expenditure incurred and how it is financed. The expected movement in the CFR over the next three years is dependent on the level of supported and unsupported capital expenditure decisions taken during the budgeting cycle.

The CFR forms one of the required prudential indicators. It includes the related capital expenditure and financing figures for each year, and the external debt for each year, which are mandatory prudential indicators.

In 2016/17 the Council agreed to borrow up to £80m to finance the acquisition of commercial properties within the Borough. In 2017/18, the Council agreed to borrow up to a further £300m to finance property investments through Epsom & Ewell Property Investment Company Limited. To date, the Council has acquired four investment properties for a combined £31m in-borough and two investment properties for a combined £60m out-of-Borough, all funded from borrowing. As a result, the CFR has increased substantially since 2015/16, when it had been nil.

Following MHCLG statutory investment guidance in April 2018, Council agreed in February 2020 to cease seeking any further out-of-Borough investment property acquisitions, where the main purpose is purely to profit, in order to meet MHCLG's statutory guidance.

The Council is asked to approve the actual CFR and actual debt figures set out below.

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	2019/20 Actual £'000	2020/21 Estimated £'000	2020/21 Actual £'000
<b><u>Capital Expenditure:</u></b>			
Capital programme expenditure	8,561	4,794	2,886
Assets acquired under finance leases	0	0	0
<b>Total Capital Expenditure</b>	<b>8,561</b>	<b>4,794</b>	<b>2,886</b>
<b><u>Capital Financing:</u></b>			
Capital receipts	664	750	257
Capital grants	854	1,099	734
Capital reserves	843	2,745	1,600
Revenue	123	200	295
<b>Total Capital Financing</b>	<b>2,484</b>	<b>4,794</b>	<b>2,886</b>
Minimum revenue provision	1,249	1,359	1,359
<b>Capital Financing Requirement at 31 March</b>	<b>91,636</b>	<b>90,277</b>	<b>90,277</b>
<b><u>External Debt:</u></b>			
External borrowing	64,427	64,427	64,427
Other short/long term liabilities	3,401	3,401	2,666
<b>Total External Debt at 31 March</b>	<b>67,828</b>	<b>67,828</b>	<b>67,093</b>
Internal borrowing	23,808	22,449	23,184
<b>Capital Financing Requirement at 31 March</b>	<b>91,636</b>	<b>90,277</b>	<b>90,277</b>

#### 4. External Debt

A key control over the Council's activity is to ensure that over the medium term net borrowing will only be for a capital purpose. The Council needs to ensure that net external borrowing does not, except in the short term, exceed the total of capital financing requirement in the preceding year plus the estimates of additional capital financing requirement for 2020/21 and next two financial years.

The following table sets out the actual levels of borrowing and investment for 2020/21

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	<b>2019/20 Actual £'000</b>	<b>2020/21 Estimated £'000</b>	<b>2020/21 Actual £'000</b>
Gross Borrowing at 31 March	67,828	67,828	67,093
Investments at 31 March	14,600	11,316	18,700
Net Borrowing at 31 March	53,228	56,512	48,393
<b>Capital Financing Requirement Movement</b>	<b>4,828</b>	<b>(1,359)</b>	<b>(1,359)</b>

The Chief Finance Officer reports that the Council complied with the requirement to keep net borrowing below the CFR in 2020/21, and no difficulties are envisaged for the current or future years. This view takes into account current commitments and plans in the budget report.

A further two Prudential Indicators control the overall level of borrowing. These are:

#### The Authorised Limit

The authorised limit is the affordable borrowing limit determined in compliance with the Local Government Act 2003. It is the absolute maximum amount of debt that the Council can legally owe. The authorised limit provides headroom over and above the operational boundary for unusual cash movements.

#### The Operational Boundary

The operational boundary is based on the Council's estimate of most likely (i.e. prudent but not worst case) scenario for external debt. It links directly to the Council's estimates of capital expenditure, the capital financing requirement and cash flow requirements, and is a key management tool for in-year monitoring.

The Council is asked to approve the authorised and operational limits set out below.

	<b>2019/20 Actual £'000</b>	<b>2020/21 Estimated £'000</b>	<b>2020/21 Actual £'000</b>
<b><u>Authorised Limit for External Debt</u></b>			
Borrowing for commercial properties	64,427	100,000	64,427
Other short/long term liabilities (finance leases) *	3,401	3,000	2,666
<b>Total Authorised Limit for External Debt</b>	<b>67,828</b>	<b>103,000</b>	<b>67,093</b>
<b><u>Operational Boundary for External Debt</u></b>			
Borrowing for commercial properties	64,427	91,636	64,427
Other short/long term liabilities (finance leases) *	3,401	2,666	2,666
<b>Total Operational Boundary for External Debt</b>	<b>67,828</b>	<b>94,302</b>	<b>67,093</b>

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\* 2019/20 figure has previously been reported as £3,046k, which was the long-term liability at 31 March 2020 due in over one year. The 2019/20 figure has now been updated to also include the short term liability of finance leases (amounts due within one year, which was £355k at 31 March 2020), and will be reported on this basis going forward.

### **5. Treasury Management Indicators**

The purpose of the treasury management prudential indicators is to contain the activity of the treasury function within certain limits, thereby reducing the risk or likelihood of an adverse movement in interest rates or borrowing decisions impacting negatively on the Council's overall financial position. However, if these are set to be too restrictive they will impair the opportunities to reduce costs or maximise investment income.

The treasury management service is an important part of the overall financial management of the Council's affairs. Its importance has increased as a result of the freedoms provided by the Prudential Code. It covers the borrowing and investment activities and the effective management of associated risks. Its activities are strictly regulated by statutory requirements and a professional code of practice, the CIPFA Code of Practice for Treasury Management in Local Authorities.

The Council adopted the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice at its meeting in April 2012 and Council approved the latest treasury management strategy and procedures in February 2021.

The treasury management policy requires an annual strategy to be reported to Members outlining the expected treasury activity for the forthcoming year. A further report is produced after the year end to report on actual activity for the year.

The treasury management strategy identifies four prudential indicators in respect of treasury management:

#### Upper Limits on Fixed Rate Exposure

This indicator identifies a maximum limit for the Council's exposure to fixed interest rates for borrowing based upon the debt position net of investments.

#### Upper Limits on Variable Rate Exposure

This indicator identifies a maximum limit for the Council's exposure to variable interest rates for borrowing based upon the debt position net of investments. The Council has no plans to enter into any variable rate borrowing arrangements.

#### Maturity Structures of Borrowing

This indicator sets out the gross limits on borrowing which are set to limit the Council's exposure to large fixed rate sums falling due for refinancing.

#### Total Principal Funds Invested for Periods Longer Than 364 Days

This indicator limits the amount of long-term investments which can be sold in each year, to reduce the need for early sale of an investment.

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	<b>Figures are for the financial year unless otherwise titled in italics</b>	<b>2019/20 Actual £'000</b>	<b>2020/21 Estimated £'000</b>	<b>2020/21 Actual £'000</b>
<b>1</b>	<b>Capital Expenditure</b>	8,561	4,794	2,886
<b>2</b>	<b>Capital Financing Requirement (CFR) <i>at 31 March</i></b>	91,636	90,277	90,277
<b>3</b>	<b>Treasury Position at 31 March</b> External borrowing Other short/long term liabilities <b>Total Debt</b> Investments <b>Net Borrowing</b>	64,427 3,401 <b>67,828</b> 14,600 <b>53,228</b>	64,427 3,401 <b>67,828</b> 11,316 <b>56,512</b>	64,427 2,666 <b>67,093</b> 18,700 <b>48,393</b>
<b>4</b>	<b>Maximum Debt (Actual) compared to Authorised Limit (Original Indicator)</b>	67,828	67,828	67,093
<b>5</b>	<b>Average Debt compared to Operational Boundary (Original Indicator)</b>	67,828	67,828	67,093
<b>6</b>	<b>Ratio of financing costs to net revenue stream</b>	13%	13%	15%
<b>7</b>	<b>Upper limits on fixed interest rates (<i>against maximum position</i>) as above</b>	67,828	67,828	67,093
<b>8</b>	<b>Upper limits on variable interest rates (<i>against maximum position</i>) as above</b>	0	0	0
<b>9</b>	<b>Maturity structure fixed rate borrowing (%)</b>	<b>2019/20 Actual</b>	<b>2020/21 Estimated</b>	<b>2020/21 Actual</b>
<b>10</b>	Under 12 months 12 months to 2 years 2 years to 5 years 5 years to 10 years 10 years and above <b>Maximum principal funds invested over 364 days (<i>against maximum position</i>)</b>	0% 0% 0% 8% 92%	0% 0% 0% 8% 92%	0% 0% 0% 8% 92%
		0	£10m	0