COUNCIL
11 FEBRUARY 2016

APPROVAL OF PRUDENTIAL INDICATORS AND AUTHORISED LIMITS FOR 2016/17

1. Introduction

The Local Government Act 2003 introduced a system of capital controls for Local Authorities, and came into effect from April 2004. 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 previous system of credit approvals, Basic Credit Approvals (BCA) and Supplementary Credit Approvals (SCA), was abolished and there is no restriction on capital investment, subject to government reserving powers to restrict borrowing for national economic reasons. With the abolition of the BCA/SCA framework, capital investment is supported through supported capital expenditure (revenue) which is incorporated in the capital finance Formula Spending Share calculations in a similar way to that of credit approvals.

In addition the Act requires all local authorities to comply with the Chartered Institute of Public Finance and Accountancy (CIPFA) Prudential Code approved in September 2003 and updated in September 2004. 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 budget report has been modified to comply with the requirements of the Code.

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 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 Indicators relevant to the Council and sets out the indicators for approval as part of the Council's budget setting for 2016/17.

2. Affordability Prudential Indicators

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 indicator identifies the trend in the cost of capital (borrowing costs net of interest and investment income) against the net revenue stream.

As the Council is debt free and has net investment income this indicator is negative and represents the extent to which the Council is reliant on investment income to support its revenue budget provision.

Estimates of the Incremental Impact of Capital Investment Decisions on the Council Tax

This indicator identifies the trend in the cost of proposed changes in the three year capital programme recommended in the budget report compared to the Council's existing commitments and plans. The forward assumptions are based on the those included in the budget report, but will invariably include some areas, such as the level of government support, which is not published over a three year period.

The incremental impact on council tax for each year is expressed as a percentage increase. This increase equates to the level investment in capital expenditure funded from reserves that could have alternatively been invested to generate investment income. Capital expenditure plans are anticipated to be financed from existing capital receipt reserves rather than from new receipts and there are revenue consequences arising from capital expenditure plans.

The Council is asked to note the affordability indicators set out below.

	2014/15 Actual	2015/16 Probable	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
Ratio of Financing Costs to Net Revenue Stream	-2%	-2%	-1%	-1%	-2%
Incremental Impact of Capital Investment Plans on Council Tax Band D	1%	3%	1%	1%	0%

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 a capital purpose, and the change year on year will be influenced by the capital expenditure in each year and how it's 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 supported element of capital expenditure is that expenditure financed from existing reserves or capital receipts plus borrowing that is the supported capital expenditure under the previous capital controls regime. The unsupported element is the freedom allowed under the Prudential Code for capital expenditure financed from borrowing.

The Council's expectations for the CFR in the next three years are shown in the table below, with the associated expectation for funding for the movement. This forms one of the required prudential indicators. Included also is the related capital expenditure figures for each year, split between supported and unsupported spending, and the expected external debt for each year. Both these are also mandatory prudential indicators.

A key risk of the plan is that the level of government grant and other sources of funding have been estimated and are therefore subject to change.

The Council has been debt free since 1994 and has no underlying need to borrow for a capital purpose. For the four year period 2015-19 the Council does not anticipate any borrowing requirement for capital expenditure plans, although there is a need to identify an asset disposal programme to generate capital receipts to fund future planned capital expenditure. The CFR for the Council over the next four years is nil.

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

	2014/15 Actual £'000	2015/16 Probable £'000	2016/17 Estimate £'000	2017/18 Estimate £'000	2018/19 Estimate £'000
Capital Expenditure:					
Total Capital Expenditure	**3,485**	**5,534**	**1,031**	**1,093**	**386**
Capital Financing:					
Borrowing	-	-	-	-	-
Capital reserves	612	1,921	695	779	100
Capital grants	245	291	286	286	286
Other capital contributions	757	3,077	-	-	-
Revenue	1,871	245	50	28	-
Total Capital Financing	**3,485**	**5,534**	**1,031**	**1,093**	**386**
Capital Financing Requirement (CFR)	**nil**	**nil**	**nil**	**nil**	**nil**
Movements in CFR	**nil**	**nil**	**nil**	**nil**	**nil**

External Debt:					
Borrowing	**nil**	**nil**	**nil**	**nil**	**nil**
Other long term liabilities	**nil**	**nil**	**nil**	**nil**	**nil**
Total External Debt at 31 March	**nil**	**nil**	**nil**	**nil**	**nil**

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 the years 2015/16 to 2018/19.

The table below sets out the actual and estimated levels of borrowing and investment up to 2018/19.

	2014/15 Actual £'000	2015/16 Probable £'000	2016/17 Estimate £'000	2017/18 Estimate £'000	2018/19 Estimate £'000
Gross Borrowing at 31 March	-	-	-	-	-
Investments at 31 March	21,380	19,459	18,764	17,985	17,885
Net Borrowing at 31 March	(21,380)	(19,459)	(18,764)	(17,985)	(17,885)
Capital Financing Requirement	-	-	-	-	-

The Director of Finance and Resources reports that the Council complied with the requirement to keep net borrowing below the relevant CFR in 2014/15 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

This represents the limit beyond which borrowing is prohibited. It reflects the level of borrowing which, while not desired, could be afforded in the short term, but is not sustainable. It is the expected maximum borrowing need with some headroom for unexpected movements.

The Operational Boundary

This indicator is based on the probable external debt during the course of the year; it is not a limit and actual borrowing could vary around this boundary for short times during the year. It should act as an indicator to ensure the authorised limit is not breached.

In line with the Council's Financial Strategy and Capital Strategy which does not anticipate any borrowing over the four year period 2015-19 the operational boundary will be set at nil.

An authorised limit has been set to take into account any potential short term borrowings which may arise during the year due to temporary cash flow shortfalls.

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

	2014/15 Actual £'000	2015/16 Probable £'000	2016/17 Estimate £'000	2017/18 Estimate £'000	2018/19 Estimate £'000
Authorised Limit for External Debt					
Borrowing	5,000	5,000	5,000	5,000	5,000
Other long term liabilities	-	-	-	-	-
Total Authorised Limit for External Debt	**5,000**	**5,000**	**5,000**	**5,000**	**5,000**
Operational Boundary for External Debt					
Borrowing	-	-	-	-	-
Other long term liabilities	-	-	-	-	-
Total Operational Boundary for External Debt	-	-	-	-	-

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 optimise 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. This Council adopted the Code of Practice on Treasury Management in April 2010 and Strategy and Resources Committee approved a revised treasury management policy statement and procedures in March 2015.

The treasury management policy requires an annual strategy to be reported to Strategy and Resources Committee outlining the expected treasury activity for the forthcoming year. In line with the CIPFA Code of Practice, two reports are produced, an interim and a final end of year report to provide information on actual activity for the year. In line with

Department of Communities and Local Government (DCLG) guidance it is expected that an Investment Strategy will also be prepared for approval at the beginning of each year.

In view of the limited borrowing expected to be undertaken in the three year period 2015-18, a Treasury Management Strategy was approved by Strategy and Resources Committee in March 2015 and an updated Treasury Management Strategy will be presented to Strategy and Resources Committee in March 2016.

The introduction of the Prudential Code sees the replacement of the s45 limits imposed by the Local Government and Housing Act 1989, with four new prudential indicators:

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.

Maturity Structures of Borrowing

This indicator sets out the these 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.

In line with the indicators for external debt set out above the Council will not have any net debt at any time over the next three years. The limits on fixed and variable borrowing on net debt are therefore set at nil. The limits on gross borrowing and investments at fixed and variable rates will be set as part of the Annual Treasury Management Strategy reported to Strategy and Resources in March.

Any borrowing over the next three years will be undertaken on a temporary basis and repaid within twelve months. The upper limit maturity structure for repayment is therefore set at 100% within twelve months.

The limits on fund invested longer than 364 days is based on the forecast level of investments over the next three years.

The Council is asked to approve the treasury management prudential indicators set out below:-

	2015/16 Lower to Upper Limit £'000 or %	**2016/17 Lower to Upper Limit £'000 or %**	**2017/18 Lower to Upper Limit £'000 or %**	**2018/19 Lower to Upper Limit £'000 or %**
Limits on fixed interest rates borrowings	**-**	**-**	**-**	**-**
Limits on variable interest rates borrowings	**-**	**-**	**-**	**-**
Maturity Structure of Fixed Borrowing				
Under 12 months	0 to 100%	0 to 100%	0 to 100%	0 to 100%
12 months to 2 years	-	-	-	-
2 years to 5 years	-	-	-	-
5 years to 10 years	-	-	-	-
10 years and above	-	-	-	-
Maximum Principal Sums Invested	**0 to 8,000**	**0 to 8,000**	**0 to 8,000**	**0 to 8,000**