COUNCIL
14 FEBRUARY 2017

APPROVAL OF PRUDENTIAL INDICATORS AND AUTHORISED LIMITS FOR 2017/18

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 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 2017/18.

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.

Ratio of Financing Costs to Net Revenue Stream

This indicator has been calculated as debt interest, borrowing refinancing costs, minimum revenue provision and net of investment income and divided by the General Fund (GF) budget requirement for the GF element of costs**.**

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

Ratio of Financing Costs to Net Revenue Stream	**2016/17 Probable**	**2017/18 Estimate**	**2018/19 Estimate**	**2019/20 Estimate**
General Fund	-1%	11%	11%	11%

Incremental Impact of Capital Investment Decisions on the Council Tax

This is an indicator of affordability that shows the impact of capital investment decisions on Council Tax levels. The incremental impact looks at the loss of interest which could be generated on the funds being used to finance the proposed capital programme.

Incremental Impact of Capital Investment Plans on Council Tax Band D	**2016/17 Probable £'000**	**2017/18 Estimate £'000**	**2018/19 Estimate £'000**	**2019/20 Estimate £'000**
Proposed Capital Programme	24,274	1,249	976	535
Estimated Interest earned on short term investments	1.25%	1.50%	1.75%	2.00%
Estimated Tax Base	32,013	32,324	32,324	32,324
Incremental Impact on Band D Council Tax	£9.48	£0.58	£0.53	£0

(Note that the Council Tax base is still being assessed for 2017/18 onwards and therefore the2016/17 base is used for this indicator – important to note that this indicator is for illustrative purposes as a worse-case scenario and does not actually mean an increase to Council Tax at that level for Epsom and Ewell Borough Council).

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 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 However on 21 November 2016, the Council granted approval for borrowing to finance a Commercial Property Acquisition Fund.

As a result, the CFR for the Council, which was previously nil, increases in 2016/17 to £20 million.

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

	2015/16 Actual £'000	**2016/17 Probable £'000**	**2017/18 Estimate £'000**	**2018/19 Estimate £'000**	**2019/20 Estimate £'000**
Capital Expenditure:					
Total Capital Expenditure	**2,999**	**24,274**	**1,249**	**976**	**535**
Capital Financing:					
Capital reserves	756	1,752	643	441	-
Capital grants	273	354	535	535	535
Other capital contributions	1,495	2,108	46	-	-
Revenue	475	60	25	-	-
Total Capital Financing	**2,999**	**4,274**	**1,249**	**976**	**535**
Capital Financing Requirement (CFR)	**nil**	**20,000**	**20,000**	**20,000**	**20,000**
Movements in CFR	**nil**	**20,000**	**nil**	**nil**	**nil**
External Debt:					
Borrowing	**nil**	**20,000**	**nil**	**nil**	**nil**
Other long term liabilities	**nil**	**nil**	**nil**	**nil**	**nil**
Total External Debt at 31 March	**nil**	**20,000**	**20,000**	**20,000**	**20,000**

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 2019/20.

	2015/16 Actual £'000	2016/17 Probable £'000	2017/18 Estimate £'000	2018/19 Estimate £'000	2019/20 Estimate £'000
Gross Borrowing at 31 March	-	20,000	20,000	20,000	20,000
Investments at 31 March	(27,860)	(26,108)	(25,465)	(25,024)	(25,024)
Net Borrowing at 31 March	(27,860)	(6,108)	(5,465)	(5,024)	(5,024)
Capital Financing Requirement	**-**	**20,000**	**20,000**	**20,000**	**20,000**

The Director of Finance and Resources reports that the Council complied with the requirement to keep net borrowing below the relevant CFR in 2015/16 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 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
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.

	2015/16 Probable £'000	2016/17 Estimate £'000	2017/18 Estimate £'000	2018/19 Estimate £'000	2019/20 Estimate £'000
Authorised Limit for External Debt					
Borrowing	5,000	25,000	25,000	25,000	25,000
Other long term liabilities	-	-	-	-	-
Total Authorised Limit for External Debt	**5,000**	**25,000**	**25,000**	**25,000**	**25,000**
Operational Boundary for External Debt					
Borrowing	-	20,000	20,000	20,000	20,000
Other long term liabilities	-	-	-	-	
Total Operational Boundary for External Debt	-	20,000	20,000	20,000	20,000

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.

The Council adopted the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2011 Edition at its meeting on 13 April 2012 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.

To reflect the setting up of a prudential borrowing funded £20 million Commercial Property Acquisition Fund, updated Prudential Indicators were approved by the 21 November Extraordinary Council. An updated Treasury Management Strategy will be presented to the March 2017 Strategy and Resources Committee

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.

Following the 21 November 2016 approval of £20 million prudential borrowing to fund a Commercial Property Acquisition Fund, the limit on fixed borrowing was set at £20 million. The limit will be increased to £80 million subject to approval of a further request to agree to an additional £60 million of borrowing to fund new property acquisitions. However, the limit on variable borrowing will remain 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.

The November 2016 approved Property Investment Strategy anticipated borrowing, on a "case by case basis" from the PWLB, based on "Maturity repayment loans.

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:-

	2016/17 Lower to Upper Limit £'000 or %	**2017/18 Lower to Upper Limit £'000 or %**	**2018/19 Lower to Upper Limit £'000 or %**	**2019/20 Lower to Upper Limit £'000 or %**
Limits on fixed interest rates borrowings	**20,000**	**20,000**	**20,000**	**20,000**
Limits on variable interest rates borrowings	**-**	**-**	**-**	**-**
<u>Maturity Structure of Fixed Borrowing</u>				
Under 12 months	-	-	-	-
12 months to 2 years	-	-	-	-
2 years to 5 years	-	-	-	-
5 years to 10 years	-	-	-	-
10 years and above	0 to 100%	0 to 100%	0 to 100%	0 to 100%
Maximum Principal Sums Invested	**0 to 8,000**	**0 to 8,000**	**0 to 8,000**	**0 to 8,000**