Prudential Indicators 2013-14 to 2015-16

Affordability

a) Estimates of ratio of financing costs to net revenue stream

Commentary

The indicator has been calculated as the estimated net financing costs for the year divided by the amounts to be met from government grants and local taxpayers for the non-HRA element, and by total HRA income for the HRA element. The objective is to enable trends to be identified.

The figures for both HRA and General Fund, although fluctuating slightly each year, are forecast to remain broadly stable across the three year period.

The relatively high ratio for the HRA across all years (compared to General Fund) arises from the HRA debt taken on in 2011-12 under the government's HRA self-financing agenda, and from the requirement to include depreciation in the financing costs, as represented by the value of the Major Repairs Allowance (MRA), which is not required in the General Fund figures.

The figures used for the net revenue stream for 2013-14 and onwards are dependent upon the General Fund and HRA revenue budgets to be agreed by Council and are therefore subject to change. If applicable, updated figures will be provided to Cabinet and Council at the earliest opportunity.

Risk Analysis

Debt financing costs relating to past and current capital programmes have been estimated in accordance with proper practices. Actual costs will be dependant on the phasing of capital expenditure and prevailing interest rates, and will be closely managed and monitored on an ongoing basis. Carry forwards in the capital programme, whether planned or unplanned, will delay the impacts of debt financing costs to future years.

b) Estimates of the incremental impact of new capital investment decisions on the Council Tax

Commentary

This indicator represents an estimate of the incremental impact of new capital investment decisions on the annual Council Tax (Band D). It is intended to show the effect on the Council Tax of approving additional capital expenditure.

Revenue budget impacts may arise from the following:

- Direct revenue contributions
- Lost interest on use of revenue contributions
- Lost interest on use of capital receipts
- Lost interest on use of internal borrowing
- Lost interest on use of earmarked reserves
- Interest on use of external borrowing
- Revenue running costs or savings

The figure represents the incremental impact on Council Tax from capital expenditure schemes starting in 2013-14 and planned for 2014-15 and 2015-16. For this reason continuation schemes that have already been agreed are excluded from the calculation, except where they are ongoing work programmes with discretion to vary expenditure from year to year.

The rising trend is normal and results from three factors. Firstly the cumulative impact of ongoing programmes such as the Disabled Facilities Grant programme; secondly the delay in the charging of MRP, whereby annual charges for the repayment of borrowing principal start the year after expenditure is incurred; and thirdly the cumulative effect over the three year period of interest lost on cash resources that have been applied to the capital programme.

Risk Analysis

The calculation of this indicator produces a notional figure. In practice the incremental costs of capital programme expenditure, including borrowing costs, are incorporated into the calculations for the revenue budget build along with all other proposed budget increases and savings, and are considered as part of an overall package of affordability.

Capital appraisals are completed for all new capital programme bids, and these should include any additional revenue costs associated with a scheme.

These procedures are designed to ensure that capital expenditure schemes are not included in the planned programme unless they have been demonstrated to be affordable, as well as prudent and sustainable.

c) Estimate of incremental impact of new capital investment decisions on average weekly housing rent

Commentary

This indicator represents an estimate of the incremental impact of new capital investment decisions on average weekly housing rents.

Revenue budget impacts may arise from the following:

- Direct revenue contributions
- Lost interest on use of revenue contributions
- Lost interest on use of capital receipts
- Lost interest on use of internal borrowing
- Lost interest on use of earmarked reserves
- Lost interest on use of Major Repairs Allowance (MRA)
- Interest on use of external borrowing
- Revenue running costs or savings

The figures represent the incremental impact on weekly housing rents from capital expenditure schemes starting in 2013-14 and planned for 2014-15 and 2015-16. For this reason continuation schemes that have already been agreed are excluded from the calculation, except where they are ongoing work programmes with discretion to vary expenditure from year to year.

The rising trend is normal and is primarily the result of the cumulative effect over the three year period of interest lost on cash resources that have been applied to the capital programme.

The availability of additional revenue funds to support capital expenditure is linked to the HRA self financing reforms; the abolition of subsidy payments to government (replaced by debt financing costs) are expected to allow significant capital investment, initially to meet decent homes standards, and subsequently to maintain those standards and to invest in estate regeneration and/or new homes build. Actual rent rises will remain in line with the government rent restructuring policy.

Risk Analysis

The calculation of this indicator produces a notional figure. In practice the incremental costs of capital programme expenditure, including borrowing costs, are incorporated into the calculations for the HRA revenue budget build along with all other proposed budget increases and savings, and are considered as part of an overall package of affordability.

Capital appraisals are completed for all new HRA capital programme bids, and these should include any additional revenue costs associated with a scheme.

These procedures are designed to ensure that HRA capital expenditure schemes are not included in the planned programme unless they have been demonstrated to be affordable, as well as prudent and sustainable.

Prudence

d) Gross debt and the capital financing requirement

Commentary

This is a key indicator of prudence. It is intended to show that debt does not, except in the short term, exceed the total of capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and new two financial years. This demonstrates that the Council's borrowing has only been undertaken for a capital purpose.

Risk Analysis

Where the gross debt is greater than the capital financing requirement the reasons for this should be clearly stated in the annual strategy.

Capital Expenditure

e) Estimate of capital expenditure

Commentary

This indicator requires reasonable estimates of the total of capital expenditure to be incurred during the forthcoming financial year and at least the following two financial years.

The draft capital programme for 2013-14 to 2015-16 is included elsewhere on this agenda and the prudential indicator figures are based on that report.

Estimates include continuation schemes from previous years, where applicable. Outline proposals for new bids starting in 2014-15 and 2015-16 are not included for General Fund schemes at this stage. The programme will be adjusted as necessary in line with the actual bids submitted and the resources available when the annual programmes for the two years are agreed.

Risk Analysis

There is a real risk of cost variations to planned expenditure against the capital programme, arising for a variety of reasons, including tenders coming in over or under budget, changes to specifications, and slowdown or acceleration of project phasing. There is also the possibility of needing to bring urgent and unplanned capital works into the capital programme. The risks are managed by officers on an ongoing basis, by means of active financial and project monitoring. Any significant issues are reported to Cabinet as part of the finance and performance reporting cycle.

The availability of financing from capital receipts, grants and external contributions also carries significant risk. This can be particularly true of capital receipts, where market conditions are a key driver to the flow of funds, causing particular problems in a depressed or fluctuating economic environment. A prudent approach has been taken to these funding streams in the proposed capital programme for 2013-14 to 2015-16. New capital schemes funded by receipts are not approved until receipts are actually realised.

The financing position of the capital programme is closely monitored by officers on an ongoing basis and any significant issues are reported to Cabinet as part of the finance and performance reporting cycle.

f) Estimate of capital financing requirement (CFR)

Commentary

External borrowing arises as a consequence of all the financial transactions of the authority and not simply those arising from capital spending. The CFR can be understood as the Council's underlying need to borrow money long term for a capital purpose – that is, after allowing for capital funding from capital receipts, grants, third party contributions and revenue contributions.

The Council is required to make reasonable estimates of the total CFR at the end of the forthcoming financial year and the following two years thereafter. A local authority that has an HRA must identify separately estimates of the HRA and General Fund CFR.

The CFR has been calculated in line with the methodology required by the relevant statutory instrument and the guidance to the Prudential Code. It incorporates the actual and forecast borrowing impacts of the Council's previous, current and future capital programmes.

The forecast trend for the General Fund CFR is a very gentle decrease over the forthcoming three-year period, as the amount of proposed borrowing is offset by annual repayments of principal (Minimum Revenue Provision).

The HRA CFR is forecast to remain static for the three year period as no new borrowing is planned to support the HRA capital programme.

The changes to CFR for future years (2014-15 and 2015-16) are subject to future Council decisions in respect of the capital programme for those years

Risk Analysis

The capital financing requirement will vary from the estimates if there are changes to capital programme plans that result in reduced or increased borrowing to support expenditure. This will include adjustments between years as a result of carry forwards in the capital programme, which can impact on the profile of capital expenditure and the profile of the minimum revenue provision.

All borrowing plans must be affordable in revenue terms and to this end additional borrowing to fund capital expenditure will only be approved through the normal capital project approval process and where it has been demonstrated to be prudent affordable and sustainable.

<u>External Debt</u>

g) Authorised limit for total external debt

Commentary

For the purposes of this indicator the authorised limit for external debt is defined as the authorised limit for borrowing plus the authorised limit for other long term liabilities for years 1, 2 and 3.

This requires the setting for the forthcoming financial year and the following two financial years of an authorised limit for total external debt (including temporary borrowing for cash flow purposes), gross of investments, separately identifying borrowing from other long term liabilities.

The authorised limit represents the maximum amount the Council may borrow at any point in time in the year. It has to be set at a level the Council considers is “prudent” and be consistent with plans for capital expenditure and financing. It contains a provision for forward funding of future years capital programmes, which may be utilised if current interest rates reduce significantly but are predicted to rise in the following year.

This limit is based on the estimate of the most likely but not worst case scenario, with in addition sufficient headroom over and above this to allow for operational management, for example unusual cash movements.

The authorised limit is set at an amount that allows a contingency for any additional unanticipated or short-term borrowing requirements over and above the operational boundary during the period (see (h) below).

Other long-term liabilities relate to finance leases and credit arrangements.

Council may delegate authority to the S.151 Officer to effect movement between the separately agreed figures for borrowing and other long-term liabilities within the operational boundary. Any such changes should be reported to the Council at the next meeting following the change.

Risk Analysis

Risk analysis and risk management strategies have been taken into account in setting this indicator, as have plans for capital expenditure, estimates of the capital financing requirement and estimates of the Council’s cash flow requirements.

h) Operational Boundary for total external debt

Commentary

The proposed operational boundary is based on the same estimates as the authorised limit. However it excludes the additional headroom included within the authorised limit to allow for unusual cash movements.

The operational boundary represents a key management tool for in year monitoring by the S.151 Officer.

Within the operational boundary, figures for borrowing and other long-term liabilities are separately identified.

The borrowing element of the operational boundary has been set with reference to the maximum Capital Financing Requirement (CFR) over the coming three years.

Other long-term liabilities relate to finance leases and credit arrangements.

Council may delegate authority to the S.151 Officer to effect movement between the separately agreed figures for borrowing and other long-term liabilities within the operational boundary. Any such changes should be reported to the Council at the next meeting following the change.

Risk Analysis

Risk – Risk analysis and risk management strategies have been taken into account in setting this indicator, as have plans for capital expenditure, estimates of the capital financing requirement and estimates of the Council’s cash flow requirements.

i) **HRA Limit on Indebtedness**

Commentary

The local authority is required to report the level of the limit imposed (or subsequently amended) at the time of implementation of self-financing by the Department for Communities and local Government. It is the HRA capital financing requirement that will be compared to this limit.

Risk Analysis

The HRA business plan has been modelled with full regard to the CLG debt cap requirements. The risk assessment of the business plan does not identify the breach of the debt cap as a risk. However there is an identified risk that inflation levels may change more than expected, resulting in the financial assumptions in the business plan proving to be inaccurate, leading to reduced headroom for borrowing. In this instance borrowing may reach (but not breach) the debt cap.

Treasury Management

j) Adoption of the CIPFA Code of Practice for Treasury Management

Commentary

The Prudential Code requires that the local authority has adopted the CIPFA Treasury Management in the Public Services: Code of Practice and Cross Sectoral Guidance Notes. The aim is to ensure that treasury management is led by a clear and integrated forward looking treasury management strategy, and recognition of the pre-existing structure of the authority's borrowing and investment portfolios.

Risk Analysis

Effective risk management is a fundamental requirement for the treasury management function, and this theme runs explicitly through the Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes.

The prime policy objectives of the Council's investment activities are the security and liquidity of funds, and return on investments will be considered only once these two primary objectives have been met. The Council will thereby avoid exposing public funds to unnecessary or unquantified risk.

The Council's Treasury Management Strategy Report for 2013-14 to 2015-16 (including appendices) discusses the ways in which treasury management risk will be determined, managed and controlled.