PART I

Release to Press

Meeting: **Executive**

Portfolio Area: Resources

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THE PRUDENTIAL CODE FOR CAPITAL FINANCE IN LOCAL AUTHORITIES
(Chief Executives)

KEY DECISION

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1 PURPOSE

To approve the Prudential Indicators for 2004/05.

2 RECOMMENDATIONS

That Council be recommended to adopt the Prudential Code Indicators as follows:-

2.1 The actual capital expenditure that was incurred in 2002/03 and the estimates of capital expenditure for the current and future years that are recommended for approval are:

	Capital Expenditure				
	2002/03 Actual £000's	2003/04 Probable £000's	2004/05 Estimate £000's	2005/06 Estimate £000's	2006/07 Estimate £000's
General Fund	5,029	14,739	9,366	5,100	4,836
HRA	9,851	11,449	11,178	11,000	9,383
Total	14,880	26,188	20,544	16,100	14,219

2.2 Estimates of the ratio of financing costs to net revenue stream for the current and future years, and the actual figures for 2002/03 are:-

	2002/03 Actual %	2003/04 Probable %	2004/05 Estimate %	2005/06 Estimate %	2006/07 Estimate %
Financing Costs re. General Fund Capital Exp	0.92	4.35	9.35	11.70	12.64
HRA Capital Exp	1.76	4.31	7.00	8.50	9.36

2.3 Estimates of the end of year capital financing requirement for the current and future years and the actual capital financing requirement at 31st March 2003 are:

31/03/03 Actual £000's	31/03/04 Probable £000's	31/03/05 Estimate £000's	31/03/06 Estimate £000's	31/03/07 Estimate £000's
-4,878	-5,000	-5,000	-5,000	-5,000

2.4 The estimated incremental impact of capital expenditure budget proposals on Band D Council Tax is as follows:

2004/05	2005/06	2006/07
£12	£20	£14

2.5 In order to ensure that over the medium term net borrowing will only be for capital purposes, net external borrowing should not exceed the total of capital financing requirements in the preceding year plus estimated current and next 2 years requirement.

2.6 Authorised limit for external debt:

	2002/03 £000's	2003/04 £000's	2004/05 £000's	2005/06 £000's	2006/07 £000's
Borrowing	15,000	15,000	15,000	15,000	15,000
Other Long Term Liabilities	Nil	Nil	Nil	Nil	Nil

2.7 The Code also requires an Operational Limit to be set which can be less than the Authorised Limit. However, in this Council's circumstances it is recommended that the Operation Limit equates to the Authorised Limit.

2.8 The Council has adopted the CIPFA Code of Practice for Treasury Management and manages its treasury position in terms of borrowings and investments in accordance with the code.

2.9 Upper limit of variable interest rate exposure as a percentage of total debt:

2002/03	2003/04	2004/05	2005/06	2006/07
100%	100%	100%	100%	100%

2.10 Short term borrowing limit:

2002/03 £000's	2003/04 £000's	2004/05 £000's	2005/06 £000's	2006/07 £000's
15,000	15,000	15,000	15,000	15,000

3 BACKGROUND

3.1 Under Part IV of the Local Government and Housing Act 1989, the amount that Councils could borrow was controlled by the issue of Credit Approvals. Various borrowing limits had to be approved before the start of each financial year and approval was sought as part of the overall Budget report to Executive and Council.

3.2 As the Council has had debt free status since March 2001, only short term borrowing for cash flow management purposes is currently undertaken and, therefore, the overall and short term limits are identical. In addition, the variable interest proportion was set at 100% - short-term borrowing is likely to be minimal but could consist of only one loan - at variable or fixed rate depending on the availability of funds in the money market.

3.3 The limits set for 2003/04 were:-

Overall Borrowing Limit - £15million
Short Term Borrowing Limit - £15 million
Variable Interest Proportion Limit - 100%

3.4 From April 2004 Part IV is repealed and the Local Government Act 2003 applies together with Statutory Instrument 3146 The Local Authorities (Capital Finance and Accounting) Regulations 2003.

4 REASONS FOR RECOMMENDED COURSE OF ACTION AND OTHER OPTIONS

4.1 Under the new legislation Credit (borrowing) Approvals are abolished in favour of a system in which Affordable Borrowing Limits are to be determined with regard to the code of practice published by CIPFA `The Prudential Code for Capital Finance in Local Authorities'.

4.2 The Government has retained reserve powers to set limits on borrowing for national economic reasons and also to set limits for a particular authority.

4.3 The regulations do not cover Investments other than to require authorities to have regard to the CIPFA Treasury Management Code.

4.4 Key objectives of the Prudential Code are :-

- To ensure that capital investment plans are affordable, prudent and sustainable.
- To ensure treasury management decisions accord with good professional practice and in a manner that supports affordability, prudence and sustainability.
- To be consistent with and support local strategic planning, local asset management planning and option appraisal.

4.5 To demonstrate the achievement of these objectives the Prudential Code sets out indicators that must be used and the factors that must be taken into account. The code does not suggest limits or ratios as these are for the authority to determine.

4.6 The prudential indicators are designed to support and record local decision making. They are not intended to be comparative performance indicators and their use in this way would be likely to be misleading. In particular, authorities will have widely different debt positions at the start of the Prudential system and the exercise of local choice could increase these differences.

4.7 The Act refers to affordability only, whereas the Code refers to affordability and prudence. The two are related concepts. When making a decision to invest in capital assets an authority must not only determine whether it can afford the immediate cost. To ensure long term affordability the decisions have also to be prudent and in the long term sustainable. Therefore in carrying out their duties in respect of affordability an authority is required to have regard to all the aspects of the Code that relate to affordability, sustainability and prudence. The code also requires an authority to have regard to wider management processes (option appraisal, asset management planning, strategic planning and achievability) in accordance with good professional practice.

4.8 The Code promotes transparency by using information in the published statements of accounts.

4.9 The authority should have a treasury management strategy within which borrowing and investments are managed in accordance with good professional practice. Stevenage Council has a treasury management strategy in place.

4.10 <u>Governance</u>

4.10.1 The Code sets out the procedure for setting and revising prudential indicators. The body that decides the authority's budget ie full Council will do this. The Chief Financial Officer is responsible for reporting and monitoring.

4.10.2 Indicators for previous years will be taken directly from information in the statement of accounts. If any relevant item is subject to audit qualification this must be highlighted when the indicators are set/revised.

4.10.3 Indicators for the forthcoming and following years must be set before the beginning of the forthcoming year. They may be revised at any time, following due process, and must be reviewed for the current year when the prudential indicators are set for the following year.

4.10.4 Prudential indicators for treasury management should be considered along with the treasury management strategy and the annual report on treasury management activities.

4.11 <u>Affordability</u>

4.11.1 The objective here is to ensure that total capital investment remains within sustainable limits and, in particular, to consider the impact on Council Tax.

4.11.2 In considering the affordability of its capital plans, the authority is required to consider all of the resources available, together with the totality of its capital plans, revenue income and expenditure forecasts for the forthcoming year and the following two years, plus known significant variations beyond this timeframe. This necessitates as a minimum three-year capital revenue and Council Tax forecasts. Stevenage

Council has medium term revenue and capital forecasts in place for both General Fund and Housing

4.11.3 Affordability considerations should include risk and uncertainty and risk analysis and risk management strategies should be taken into account.

The affordability indicators include:-

Looking ahead for a 3 year period
- estimates of capital expenditure
- estimates of the ratio of financing costs to net revenue stream.
- estimates of capital financing requirements (need to borrow)
- estimates of the incremental impact of capital investment decisions on the Council Tax
- authorised limit for external debt
- operational limit for external debt

After the year end
- actual capital expenditure
- actual ratio of financing costs to net revenue stream.
- actual capital financing requirements
- actual external debt

4.11.4 Both the authorised and operational limits for external debt need to be consistent with the plans for capital expenditure and accounting, and with the treasury management policy and practices. The operational limit should be based on a prudent but not worst case scenario, whilst the authorised limit can include headroom over and above the authorised limit, sufficient for example for unusual cash flow movements.

4.12 <u>Prudence and Sustainability</u>

4.12.1 As noted earlier, prudential indicators in respect of external debt must take account of affordability. Through this means the objectives of prudence and sustainability are addressed year on year.

4.12.2 To ensure that over the medium term net borrowing is only for capital purposes, an authority must ensure that, except in the short term, net external borrowing does not exceed the total capital financing requirements of the previous year's actual plus current and next 2 years estimates.

4.12.3 Prudence also includes that treasury management is carried out in accordance with good professional practice. The relevant indicators are:-

- Net external borrowing not to exceed the preceding years capital financing requirement plus current and next year's estimated capital financing requirement

- compliance with the CIPFA Code of Practice for Treasury Management

- upper limits on fixed interest rate and variable interest rate exposures

- upper and lower limits for the maturity structure of borrowings

- upper limit for principal sums invested for longer than 364 days

A schedule of Prudential Code Indicators with explanatory notes is attached at Appendix A.

5 IMPLICATIONS

5.1 Financial Implications

None as a direct result of this report.

5.2 Legal Implications

None

5.3 Policy Implications

5.4 The proposed limits are in line with current policy.

BACKGROUND DOCUMENTS

- Statutory Instrument 2003 No 3146 The Local Authorities (Capital Finance and Accounting) (England) Regulations 2003
- CIPFA Prudential Code for Capital Finance in Local Authorities

APPENDICES

- Prudential Code Indicators