The Prudential Code and Indicators – outturn 2011/12

Introduction:

The Prudential code set out a framework for self-regulation of capital spending which allows councils to borrow money to fund capital projects without any limit provided the plans are affordable, prudent and sustainable. In order to demonstrate this, the Code required the Council to set a minimum number of specific prudential indicators. These indicators must be monitored during the year and revised by the Council as necessary.

The indicators fall into three categories, according to whether they relate to Capital expenditure, External debt or Treasury Management. A comparison of the outturn indicators with those set by the Council in February 2012, with an explanation of variances and subsequent revisions to the 2011/12 indicators requiring approval follows:

Capital Expenditure Indicators

Forecast Capital Expenditure

The Code requires the Council to estimate its total capital expenditure, split between the Housing Revenue Account (HRA) and non HRA.

The following table includes estimated and actual expenditure incurred in 2011/12, the original estimate for 2012/13 and revised estimate for 2012/13 resulting from the impact of the 2011/12 outturn position. The actual outturn position for 2011/12 is to be noted and the revised estimate for 2012/13 (marked *) to be approved by Members.

Capital Expenditure

Capital programme	2011/12 Revised £000	**2011/12 Outturn £000**	2012/13 Estimate 10/02/12 £000	**2012/13/ * To be Revised 25/06/12 £000**
General Fund	9,244	**5,390**	9,829	**13,673**
HRA	4,989	**4,740**	5,192	**5,192**
Total	**14,233**	**10,130**	**15,021**	**18,865**

The main variance between 2011/12 revised and 2011/12 actual on the General Fund is due to the non purchase of vehicle replacements, delay in purchasing car parking technology equipment and minor slippages on other capital projects planned for 2011/12. The under spend will be required in 2012/13 to complete these projects, which has been incorporated into the 2012/13 revised figures for approval by members. The small variance within the HRA is due to lower than anticipated expenditure on maintaining the housing stock.

Estimates of the ratio of financing costs to the net revenue stream

This is an indicator of affordability. It would not be prudent for borrowing costs to be a significant proportion of net revenue either now or in the future.

The following table includes the actual figures for 2010/11 and estimates and the actual for 2011/12 of the ratio of financing costs to net revenue stream.

Ratio of Financing Costs to Net Revenue Stream

	2010/11 Actual	**2011/12 Revised**	**2011/12 Outturn**
Non-HRA	4.09%	5.28%	**5.05%**
HRA	2.31%	2.54%	**2.66%**

Capital Financing Requirement

The capital financing requirement measures the authority's underlying need to borrow for capital purposes. In accordance with best professional practice, Cheltenham Borough Council does not associate borrowing with particular items or types of expenditure. The authority has an integrated treasury management strategy and has adopted the CIPFA Code of Practice for Treasury Management in the Public Services. Cheltenham Borough Council has, at any point in time, a number of cashflow scenarios both positive and negative, and manages its treasury position in terms of its borrowings and investments in accordance with its approved treasury management strategy and practices. In day to day cash management, no distinction is made between revenue cash and capital cash. External borrowing arises as a consequence of all the financial transactions of the authority and not simply those arising from capital spending.

The Council can borrow without limit, provided it ensures such borrowing is affordable, prudent and sustainable.

The following table includes the estimated and actual capital financing requirement at 31/3/12, the original estimate for 31/3/13 and revised estimate for 31/3/13 (marked *) resulting from the impact of the 2011/12 outturn position. The actual outturn position at 31/3/12 is to be noted and revised estimate for 31/3/13 is to be approved by Members.

Capital Financing Requirement (CFR)

	31/03/12 Estimate £000	**31/03/12 Actual £000**	31/03/13 Estimate 10/02/2012 £000	**31/03/13 * Estimate £000**
Non-HRA	27,354	24,883	30,013	31,386
HRA	46,142	46,142	44,750	44,750
Total CFR	**73,496**	**71,025**	**74,763**	**76,136**

Net borrowing and the Capital Financing Requirement

CIPFA's Prudential Code for Capital Finance in Local Authorities includes the following as a key indicator of prudence:

"In order to ensure that over the medium term net borrowing will only be for a capital purpose, the local authority should ensure that the net external borrowing does not, except in the short term, exceed the total of the capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years."

Local authorities may borrow temporarily to cover cash flow shortages but over the medium term should only borrow to finance capital expenditure.

In order to ensure that over the medium term net borrowing will only be for capital purposes, the Council needs to ensure that its net external borrowing does not exceed its Capital Financing Requirement over the current and next three years. The table below demonstrates that the estimated and actual level of net investments remains lower than the capital financing requirement in each year, and therefore meets this requirement.

The actual outturn position for 2010/11 is to be noted and the revised estimate for 2011/12 (marked *) to be approved by Members.

Estimated net borrowing and capital financing requirement at year end

	2011/12 £'000 Estimate	**2011/12 £'000 Outturn**	2012/13 £'000 Estimate 10/02/2012	**2012/13 £'000 Estimate 25/6/12 ***
Gross borrowing	72,706	72,472	75,298	72,777
Investments	6,450	9,737	5,785	12,955
Net (Investment)/ borrowing	**66,256**	**62,735**	**69,513**	**59,822**
Capital financing requirement	**73,496**	**71,025**	**74,763**	**76,136**

As can be seen from the table, the net borrowing for the council did not breach the capital financing requirement for 2011/12.

Incremental impact of capital expenditure on the council tax and housing rents

A fundamental indicator of the affordability of capital expenditure plans is its impact on the council tax and housing rents. Any borrowing for capital purposes has an impact on the revenue account and, to the extent it is not supported by government or other contributions, on council tax and/or housing rents. Using capital receipts to fund capital expenditure also has an impact because the assets sold would no longer generate rental income or investment income. The use of revenue funding to fund capital clearly has a direct impact on the revenue account and council taxes/rents. The completed capital schemes will also have an impact in terms of running costs and income generated.

The Council must estimate the incremental impact of its capital expenditure plans on the council tax and housing rents.

The estimate of the incremental impact of capital investment decisions, over and above capital investment decisions that have previously been taken by the Council for 2011/12 and for average weekly rents were:

For the Band D Council Tax

2011/12 Estimate £	2011/12 Outturn £
nil	nil

For average weekly housing rents

2011/12 Estimate £	2011/12 Outturn £
*nil	*nil

* The Council is reducing housing rents over this period in line with the rent restructuring plan, hence capital investment decisions do not impact on the level of council house rent, but impact on the level of funds available to fund repairs.

The outturn position is the same as estimated since the council tax and housing rents were set, in February 2011, at levels to fund the capital programmes approved by Members.

External Debt Indicators

Two limits were set and monitored to ensure borrowing is prudent, affordable and sustainable. These limits, together with the Treasury Management limits discussed below, replaced the section 45 limits imposed by the Local Government and Housing Act 1989, which the Council previously approved in February/March each year.

Authorised Limit

The Council set an authorised limit for its external debt which took account of the following:

- the possible maximum level of borrowing that may need to be incurred and the limit beyond which borrowing will be prohibited
- the statutory limit specified in section 3(1) of the Local Government Act 2003
- reflects a level of borrowing which, although affordable in the short term may not be sustainable
- The 'outer boundary' of the Council's possible need to borrow.

In respect of its external debt, the Council approved the following authorised limits for its total external debt gross of investments. The Council delegated authority to the Section 151 Officer, within the total limit for any individual year, to effect movement between the separately agreed limits for borrowing and other long term liabilities, in accordance with option appraisal and best value for money for the authority.

Authorised Limit for External Debt

	2011/12 **£000**	**2012/13 Original** **£000**	**2012/13 Revised** **£000**
Borrowing	109,000	109,000	109,000
Other long term liabilities	0	0	0
Total	109,000	109,000	109,000

In setting the limit, account must be taken of the authority's current commitments, existing plans and the proposals for capital expenditure and financing, and with its approved treasury management policy statement and practices.

This limit represents the worst case scenario, i.e. the effect on the cash flow of receiving no council tax income and borrowing to the maximum of the capital financing requirement, in addition to investments held. The calculation follows a prescribed formula and is in excess of the expected levels of borrowing in accordance with Treasury.

The Council did not breach this boundary during 2011/12.

Operational Boundary

The Council approved the following operational boundary for external debt for the same time period. The operational boundary for external debt is based on the same estimates as the authorised limit but reflects directly the estimate of the most likely, prudent but not worst case scenario, without the additional headroom included within the authorised limit to allow for example for unusual cash movements. The operational boundary represents a key management tool for in year monitoring. Within the operational boundary, figures for borrowing and other long term liabilities are separately identified. The Council delegated authority to the Section 151 Officer, to effect movement between separately agreed figures for borrowing and other long term liabilities, in a similar fashion to the authorised limit.

The boundary may be breached occasionally due to unexpected cash flow shortages but a sustained breach would indicate the Council may be in danger of breaching the Authorised Limit.

Operational Boundary for External Debt

	2011/12 **£000**	**2012/13 Original** **£000**	**2012/13 Revised** **£000**
Borrowing	99,000	99,000	99,000
Other long term liabilities	0	0	0
Total	99,000	99,000	99,000

The operational boundary represents the maximum expected operational borrowing at a given time, which is significantly lower than the prescribed authorised limit. This measure reflects a more realistic view of likely cash flow scenarios, and should not be exceeded.

The Council did not breach this boundary during 2011/12.

The Council's actual external debt at 31st March 2012 was £72.472 million. It should be noted that actual external debt is not directly comparable to the authorised limit and operational boundary, since the actual external debt reflects the position at a single point in time.

Treasury Management Indicators

Adoption of the CIPFA Code of Practice for Treasury Management

Cheltenham Borough Council has adopted the CIPFA *Code of Practice for Treasury Management in the Public Services.* This includes the delegation of the day to day Treasury Management Function to the section 151 Officer.

Upper limits on interest rate exposure

The Council must set upper limits on its exposure to changes in interest rates for at least the next three years. An upper limit must be set for both fixed and variable rates covering both borrowing and investments. Investments are all classed as variable rate exposure as they are all repayable within 365 days.

The purpose of these indicators is to reduce the likelihood of an adverse movement in interest rates or borrowing / investment decisions impacting negatively on the Council's overall financial position.

The Council set an upper limit on its fixed interest rate exposures of its gross outstanding borrowing and an upper limit on its variable interest rate exposures of its gross outstanding borrowing.

This means the Section 151 Officer manages fixed interest rate exposures within the range 50% to 100% and variable interest rate exposures within the range 0% to 50%.

This has not been breached during 2011/12.

Maturity structure of borrowing

The Council set both upper and lower limits with respect to the maturity structure of borrowing. This indicator is designed to be a control over an authority having large concentrations of fixed rate debt needing to be replaced at times of uncertainty over interest rates. Therefore the aim should be a relatively even spread of debt repayment dates.

The Council sets upper and lower limits for the maturity structure of its borrowings as follows:

Amount of projected borrowing that is fixed rate maturing in each period is:

	Upper Limit	**Lower Limit**
Under 12 months	10%	0
12 months and within 24 months	20%	0
24 months and within 5 years	30%	0
5 years and within 10 years	50%	0
10 years and above	100%	0

Conclusions:

No breaches of the prudential code or indicators took place during 2011/12.

Member are asked to note the outturn for 2011/11 and approve the revisions to the 2012/13 estimates (marked with *).