

**FLINTSHIRE COUNTY COUNCIL**

**REPORT TO:**           **CABINET**

**DATE:**                 **TUESDAY, 17 FEBRUARY 2015**

**REPORT BY:**         **CORPORATE FINANCE MANAGER**

**SUBJECT:**           **PRUDENTIAL INDICATORS 2015/16 - 2017/18 AND  
REVISION OF 2014/15 PRUDENTIAL INDICATORS**

**1.00**    **PURPOSE OF REPORT**

1.01    To present proposals for setting a range of prudential indicators in accordance with the Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

**2.00**    **BACKGROUND**

2.01    The Prudential Code has been developed by the Chartered Institute of Public Finance and Accountancy (CIPFA) as a professional code of practice to support local authorities in determining their programmes for capital investment in fixed assets. Local authorities are required by Regulation to have regard to the Prudential Code when carrying out duties under Part 1 of the Local Government Act 2003.

2.02    The framework established by the Prudential Code is intended to support local strategic planning, local asset management planning and robust option appraisal. The objectives of the Code are to ensure, within a clear framework, that the capital investments plans of local authorities are **affordable, prudent and sustainable**, and that treasury management decisions are taken in accordance with good professional practice.

2.03    The Prudential Code sets out the indicators that must be used, and the factors that must be taken into account in preparing such.

**3.00**    **CONSIDERATIONS**

**3.01**    **General**

3.01.1    The prudential indicators required by the Prudential Code are designed to support and record local decision making; they are not designed to be comparative performance indicators - the use of them in this way would be likely to be misleading and counter productive. They are considered in parallel with the treasury management indicators required by the CIPFA Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes, as reported elsewhere on this agenda.

3.01.2 The Prudential Code recognises that in making capital investment decisions, and in reviewing the prudential indicators, the Council must have regard to the following:

- Service objectives, e.g. strategic planning for the authority
- Stewardship of assets, e.g. asset management planning
- Value for money, e.g. option appraisal
- Affordability, e.g. implications for Council Tax and Council housing rents
- Prudence and sustainability, e.g. implications for external borrowing
- Practicality, e.g. achievability of the forward plan

The Code does not specify how the Council should have regard to these factors, but instead concentrates on the means by which it demonstrates that the proposals are affordable, prudent and sustainable.

3.01.3 Affordability is the ultimate constraint on the amount that a local authority can spend or borrow. In practice, when making a decision to invest in a capital asset, the authority must do more than simply determine whether it can afford the immediate cost. In order to ensure long term affordability, decisions have to be prudent, and in the long term sustainable. Borrowing has to be prudent because, since future interest rates and revenue streams are uncertain, it must involve an element of risk. Furthermore, if the Council is unable to deliver its capital programme, or to afford the cost of running and maintaining the new facilities, the chosen level of capital investment will not be sustainable in the long term. Prudence and affordability are related concepts.

3.01.4 The Prudential Code specifies that prudential indicators are required to be calculated for the forthcoming financial year and two subsequent financial years, this process links in with the Medium Term Financial Plan.

### **3.02 Housing Revenue Account (HRA) – Introduction of Self Financing**

3.02.1 Agreement has been reached between the UK Government and the Welsh Government to change the financing arrangements for council housing in Wales from April 2015. Currently a negative subsidy system is in operation which requires Flintshire to make annual payments of c£6m in negative subsidy to Welsh Government and on to UK Treasury, along with the other 11 stock retaining authorities in Wales.

3.02.2 The agreement is expected to generate revenue savings allowing the Council to increase its investment in existing stock, and support the delivery of additional supply of housing. It will also provide more local accountability to tenants.

- 3.02.3 Introduction of self financing will end the negative subsidy system and annual payments. The subsidy payments will be replaced with interest payments on Public Works Loan Board (PWLB) loans that the Council must borrow to exit the subsidy system. The PWLB loans, called the settlement payment (a one-off lump sum payment classed as capital expenditure), will be paid to Welsh Government (WG) and on to UK Treasury.
- 3.02.4 WG have established an officer Steering Group and a number of work streams to undertake the considerable amount of work involved to exit the subsidy system by the 31<sup>st</sup> March 2015, which Flintshire has been contributing to. Good progress has been made to date, and the work continues.
- 3.02.5 The settlement payment will be set with reference to PWLB interest rates on 31<sup>st</sup> March 2015 and therefore cannot be confirmed at this point in time. The current projection for Flintshire is £92m, based on the latest interest rate forecast. At this value the estimated annual revenue savings are £0.5m. These figures will change up until 31<sup>st</sup> March and will be monitored closely.

### 3.03 Prudential Indicators for Capital Expenditure

- 3.03.1 Based on those resources currently allocated (including specific grants, but excluding any rephasing of expenditure from 2014/15 to future years), the estimates of capital expenditure to be incurred in 2015/16 (and the following two years), are as indicated in the table below.

<b>CAPITAL EXPENDITURE</b>			
	<b>2015/16</b>	<b>2016/17</b>	<b>2017/18</b>
	<b>Estimate</b>	<b>Estimate</b>	<b>Estimate</b>
	<b>£m</b>	<b>£m</b>	<b>£m</b>
Council Fund	50.359	17.348	7.819
Housing Revenue Account	113.620	25.606	28.520
<b>Total</b>	<b>163.979</b>	<b>42.954</b>	<b>36.339</b>

- 3.03.2 This is in line with the capital programme proposals recommended to commence in 2015/16 in the Council Fund Capital Programme 2015/16 to 2018/19 report which is included elsewhere on this agenda.
- 3.03.3 The 2015/16 HRA total includes the settlement payment required to exit the HRA negative subsidy system detailed in section 3.02 of this report.
- 3.03.4 The capital expenditure totals essentially provide the base financial data from which all other indicators follow.

### 3.04 Prudential Indicators for Affordability

- 3.04.1 Estimates of the ratio of financing costs to net revenue stream for 2015/16 based on those expenditure assumptions outlined in the Council Fund and Housing Revenue Account (HRA) budget report (both included elsewhere on this agenda), are as included in the table below; these indicators of affordability address the revenue implications of the Council's financial strategy.

<b>RATIO OF FINANCING COSTS TO NET REVENUE STREAM</b>			
	<b>2015/16</b>	<b>2016/17</b>	<b>2017/18</b>
	<b>Estimate</b>	<b>Estimate</b>	<b>Estimate</b>
	<b>%</b>	<b>%</b>	<b>%</b>
Council Fund	5.7%	5.9%	6.1%
Housing Revenue Account	20.1%	26.4%	27.0%

The Council Fund net revenue stream is the amount to be met from Welsh Government (WG) grants and local taxpayers, and the HRA equivalent is the amount to be met from WG grants and from rent payers. The estimate of financing costs includes the current commitments and the proposals included in the capital programme report.

The HRA ratio, calculated in accordance with the Prudential Code, reflects the increase in financing costs attributable to the settlement payment required to exit the HRA negative subsidy system detailed in section 3.02 of this report. The ratio does not include the revenue savings as a result of no longer paying negative subsidy which outweigh the increase in finance costs. As a result of this change to the system the HRA expects to save £0.500m per annum.

- 3.04.2 The Prudential code requires that the estimate of the incremental impact of capital investment decisions as proposed in the capital budget report, over and above capital investment decisions that have previously been taken by the Council, are reported in terms of their impact on Band D Council Tax and Housing Rents.

The Council Fund Capital Programme contains no new capital investment decisions.

The HRA Capital Programme contains capital expenditure funded by unsupported (prudential) borrowing for; the settlement payment to exit the HRA negative subsidy system detailed in section 3.02 of this report, achievement of the Welsh Housing Quality Standard (WHQS), and building new Council homes. However, the revenue savings as a result of no longer paying negative subsidy, outweighs the increase in finance costs as a result of the capital expenditure, meaning that these investment decisions haven't had an increasing impact on rent levels.

### 3.05 Prudential Indicators for Prudence

3.05.1 Estimates of the capital financing requirement, for 2015/16 are:

<b>CAPITAL FINANCING REQUIREMENT</b>			
	<b>2015/16</b>	<b>2016/17</b>	<b>2017/18</b>
	<b>Estimate</b>	<b>Estimate</b>	<b>Estimate</b>
	<b>£m</b>	<b>£m</b>	<b>£m</b>
Council Fund	181.758	194.278	194.662
Housing Revenue Account	119.308	125.797	134.731
<b>Total</b>	<b>301.067</b>	<b>320.075</b>	<b>329.393</b>

3.05.2 The capital financing requirement measures the Council's underlying need to finance capital expenditure by borrowing or other long-term liability arrangements. In accordance with best professional practice, the Council does not associate debt with particular items or type of expenditure. The authority has an integrated treasury management strategy and has adopted the CIPFA Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes. The Council has, at any point in time, a number of cash flows both positive and negative, and manages its treasury position in terms of its debt and investments in accordance with its approved Treasury Management Policy and Strategy. The Treasury Management Policy Statement 2013 - 2016 and the Treasury Management Strategy 2015/16 appear elsewhere on this agenda following consideration by the Audit Committee in January 2015. In day to day cash management, no distinction can be made between revenue cash and capital cash. External debt arises as a consequence of all the financial transactions of the Council and not simply those arising from capital spending. In contrast, the capital financing requirement reflects the Council's underlying need to finance capital expenditure by borrowing or other long-term liability arrangements.

3.05.3 CIPFA's Prudential Code for Capital Finance in Local Authorities includes the following; gross debt and the capital financing requirement, as a key indicator of prudence.

*'In order to ensure that over the medium term debt will only be for a capital purpose, the local authority should ensure 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 financing requirement for the current and next two financial years'.*

In November 2012 CIPFA issued an amendment to the Prudential Code changing the indicator from net debt (total borrowing and other long-term liabilities less any investments held) to gross debt. Following reflection that comparing the capital financing requirement to the net position i.e., net of investments, could potentially mask a position where an authority had borrowed other than for a capital purpose and then subsequently invested the surplus funds.

The Corporate Finance Manager reports no difficulty in meeting this requirement for the future period to which the prudential indicators apply. This view takes into account current commitments, existing plans, and all budget proposals.

### **3.06 Prudential Indicators for External Debt and Treasury Management**

#### **2014/15 Revised Indicators**

- 3.06.1 The Prudential Code requires that any revisions to indicators must be approved by the body that set them in this case, Council.
- 3.06.2 The exit from the HRA negative subsidy system detailed in section 3.02 of this report will require the Council to borrow to fund the settlement payment. The borrowing arrangements will be made on 31<sup>st</sup> March 2015, in the 2014/15 financial year, and the transaction will take place 2 days later on the 2<sup>nd</sup> April 2015, in the 2015/16 financial year. It is therefore necessary to ensure that the borrowing limits for both 2014/15 and 2015/16 are sufficient to complete the transaction.
- 3.06.3 Both the Authorised Limit and Operational Boundary for External Debt need to be revised from those approved by Council at its meeting of 18<sup>th</sup> February 2014. The tables below show the original estimate and revised Indicators.

<b>AUTHORISED LIMIT FOR EXTERNAL DEBT</b>		
	<b>2014/15</b>	<b>2014/15</b>
	<b>Estimate</b>	<b>Revised</b>
	<b>£m</b>	<b>£m</b>
All Borrowing (Cap/Rev)	202.300	303.100
Other Long Term Liabilities	20.100	20.100
<b>Total</b>	<b>222.400</b>	<b>323.200</b>

<b>OPERATIONAL BOUNDARY FOR EXTERNAL DEBT</b>		
	<b>2014/15</b>	<b>2014/15</b>
	<b>Estimate</b>	<b>Revised</b>
	<b>£m</b>	<b>£m</b>
All Borrowing (Cap/Rev)	182.300	279.100
Other Long Term Liabilities	10.100	10.100
<b>Total</b>	<b>192.400</b>	<b>289.200</b>

3.06.4 As stated in 3.02.5 the settlement payment and therefore the associated borrowing requirement cannot be confirmed until 31<sup>st</sup> March 2015, as the calculation is based on the PWLB interest rate on that day. The operational boundary has been increased to accommodate a settlement payment based on rates being 0.5% lower than anticipated in the HRA budget report. The authorised limit has been increased to accommodate the highest possible settlement payment. The point at which the Council would decide not to proceed with the introduction of self financing, as the costs of financing the debt outweighs the revenue savings from no longer making negative subsidy payments.

Council is asked to approve the revised Indicators for 2014/15.

#### **2015/16 - 2017/18 Indicators**

3.06.5 In respect of its external debt, it is recommended that the Council approves the following authorised limits for its total external debt gross of any investment for the next three financial years. These limits separately identify borrowing from other long term liabilities such as finance leases. The Council is asked to approve these limits and to delegate authority to the Corporate Finance Manager, 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. Any such changes made will be reported to the Council at its meeting following the change.

<b>AUTHORISED LIMIT FOR EXTERNAL DEBT</b>			
	<b>2015/16</b>	<b>2016/17</b>	<b>2017/18</b>
	<b>Estimate</b>	<b>Estimate</b>	<b>Estimate</b>
	<b>£m</b>	<b>£m</b>	<b>£m</b>
All Borrowing (Cap/Rev)	324.100	341.100	353.100
Other Long Term Liabilities	20.100	20.100	20.100
<b>Total</b>	<b>344.200</b>	<b>361.200</b>	<b>373.200</b>

The authorised limits are consistent with the authority’s current commitments, existing plans and the proposals in the capital programme report, and with its approved Treasury Management Strategy 2015/16. They are based on the estimate of most likely, prudent position with, sufficient headroom over and above this to allow for operational management, for example unusual cash movements. Risk analysis and risk management strategies have been taken into account, as have plans for capital expenditure, estimates of the capital financing requirement and estimates of cash flow requirements for all purposes.

- 3.06.6 Council is also asked to approve the following operational boundary for external debt for the same period. The proposed 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 provision, without the additional headroom included in the authorised limit to allow for example for unusual cash movements, and equates to the maximum of external debt projected by this estimate. The operational boundary represents a key management tool for in year monitoring. Within the operational boundary, figures borrowing and other long term liabilities are separately identified. Council is also asked to delegate authority to the Corporate Finance Manager, within the total operational boundary for any individual year, to effect movement between the separately agreed figures for borrowing and other long term liabilities, in a similar fashion to the authorised limit. Any such changes will be reported to Council at its next meeting following the change.

<b>OPERATIONAL BOUNDARY FOR EXTERNAL DEBT</b>			
	<b>2015/16</b>	<b>2016/17</b>	<b>2017/18</b>
	<b>Estimate</b>	<b>Estimate</b>	<b>Estimate</b>
	<b>£m</b>	<b>£m</b>	<b>£m</b>
All Borrowing (Cap/Rev)	304.100	321.100	333.100
Other Long Term Liabilities	10.100	10.100	10.100
<b>Total</b>	<b>314.200</b>	<b>331.200</b>	<b>343.200</b>

- 3.06.7 It should be noted that actual external debt is not directly comparable to the authorised limit and operational boundary, since actual external debt reflects the position at a point in time.

Council is asked to note that the authorised limit determined in 2015/16 (see section 3.06.4 above) will be the statutory limit determined under section 3 (1) of the Local Government Act 2003.



- 3.06.8 The Prudential Indicator in respect of treasury management is confirmation that the Council has adopted the CIPFA Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes (as reported elsewhere on this agenda). The aim of this indicator is to ensure that treasury management is led by a clear integrated forward treasury management strategy.

#### **4.00 RECOMMENDATIONS**

4.01 That Members approve and recommend to County Council on 17th February 2015:

- (a) the Prudential Indicators for 2015/16 - 2017/18 and revised Indicators for 2014/15 as detailed in Section 3 of the report
- (b) delegated authority for the Corporate Finance Manager to effect movements between the separately agreed limits within the authorised limit for external debt and the operational boundary for external debt (3.06.5, 3.06.6)

#### **5.00 FINANCIAL IMPLICATIONS**

5.01 As set out in the report.

#### **6.00 ANTI POVERTY IMPACT**

6.01 None directly as a result of this report.

#### **7.00 ENVIRONMENTAL IMPACT**

7.01 None directly as a result of this report.

#### **8.00 EQUALITIES IMPACT**

8.01 None directly as a result of this report.

#### **9.00 PERSONNEL IMPLICATIONS**

9.01 None directly as a result of this report.

#### **10.00 CONSULTATION REQUIRED**

10.01 None.

#### **11.00 CONSULTATION UNDERTAKEN**

11.01 None directly as a result of this report.

**12.00 APPENDICES**

12.01 None.

**LOCAL GOVERNMENT (ACCESS TO INFORMATION ACT) 1985**  
**BACKGROUND DOCUMENTS**

Various Welsh Government and CIPFA Papers.

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