FLINTSHIRE COUNTY COUNCIL

Date of Meeting	Tuesday, 14th June 2016
Report Subject	Minimum Revenue Provision and Prudential Indicators – Policy Amendments
Report Authors	Corporate Finance Manager (Section 151 Officer) & Chief Officer (Community & Enterprise)

EXECUTIVE SUMMARY

Cabinet on 17th May 2016 approved the building of 92 homes on the site of The Walks in Flint as part of the Strategic Housing and Regeneration Programme (SHARP) of which 30 of the homes will be built for rent at social housing rent levels and financed through the Housing Revenue Account capital programme. The other 62 homes will be built for rent at affordable rent levels by the Council's wholly owned company NEW Homes.

The NEW Homes Business Plan 2015/20 identifies growth through the development of 300 affordable homes between 2016 and 2020. NEW Homes has analysed the available capital funding options to develop the 62 affordable homes on the site of The Walks, Flint and identified that the preferred option would be to borrow the capital finance needed from the Council.

Loans from the Council to NEW Homes for house building purposes, in accounting terms, are classed as capital expenditure and therefore need to be included within the Council's capital programme. The Cabinet at its May meeting approved the loan to NEW Homes, and the associated changes to the Council's 2016/17 and future year's capital programme.

The changes made to the capital programme also require changes to other policies which are required to be approved by full Council. This report explains the changes required to each policy and seeks Council approval.

RECOMMENDATIONS	
1	Council approves the changes to the policy on Minimum Revenue Provision as detailed in paragraphs 1.16 and 1.17
2	Council approves the changes to the Prudential Indicators 2016/17 to 2018/19 as detailed in paragraphs 1.19 to 1.28.

REPORT DETAILS

1.00	EXPLAINING THE DEVELOPMENT OF NEW HOMES IN FLINT
1.01	NEW Homes was set up by the Council in April 2014 to improve the housing opportunities for those households which the local housing market has failed. Increasing the range of housing options for the *"squeezed middle"* is a key corporate objective for NEW Homes. The squeezed middle refers to those households whose income levels are too high to qualify for social housing, but do not earn sufficient income to be able to access, or service a mortgage independently.
1.02	The NEW Homes approved business plan sets out key elements of the company's future growth strategy to increase the number of properties owned by the company for rent at affordable rent levels over the next five years. The Cabinet has approved the NEW Homes business plan.
1.03	This plan includes the development of 300 new build properties, through the Council's Strategic Housing and Regeneration Programme (SHARP). The first proposed scheme is at The Walks, Flint which will include the provision of 62 new affordable houses and apartments.
1.04	The housing development will deliver a key strategic objective in the Council's Improvement Plan, and generate additional income in the form of interest receivable from NEW Homes.
1.05	Attached at Appendix 1 for information is the Cabinet report of the 17th May 2016 which fully explains the considerations involved in building the affordable homes in Flint and the agreement to the loan from the Council to NEW Homes, the terms of which have been delegated to the Corporate Finance Manager and Monitoring Officer.
	Council Lending to New Homes
1.06	There are 2 phases to the funding of any new housing development. The first being the construction phase during which the properties are built and the second being the operational phase when the properties are built and in this case let out.

1.07	The lending will be structured as follows: • The Council will fund the loan to NEW Homes by borrowing itself either from the Public Works Loans Board or the market, dependent on the most competitive rate at the time of borrowing. The transaction would be independent of any on lending to NEW homes. There will be 2 loans made to NEW Homes to reflect the 2 phases of the housing the development. • The first will be a short term loan during construction which is estimated to take approx. 18 months, will fund the build costs and be drawn down as needed over the 18 month period. During this phase the loan will need to be structured so that NEW Homes do not make any repayments of principle and the interest would accrue but not be payable. This is due to the fact there is no income generated from renting the properties to fund interest and capital repayments during this phase. When the properties are built the first loan will be refinanced into a second loan. • The second loan will be a longer term loan during the operational phase of renting out the properties. The loan will be secured against the properties as is common practice. The principal to be repaid by NEW Homes will be the total build costs plus the interest accrued from the 1st loan. The term will be varied to suit NEW Homes requirements subject to a maximum of 50 years, and maybe refinanced from time to time during the life of the properties to meet NEW Homes' cash flow requirements.
	Capital Programme
1.08	The loans qualify as capital expenditure and therefore have been incorporated into the Council's Capital Programme from 2016/17 to be funded from prudential borrowing. When the loan is refinanced as set out in para 1.07, it will need to be included within the capital programme for a second time, as in accounting terms a second loan is granted and used to settle the first loan, the differences reflected in the terms and conditions associated with both loans. The repayment of the first loan will be classed in accounting terms as a capital receipt which will be used to repay the prudential borrowing associated with the first loan. All of the transactions above happen simultaneously.
1.09	As the loan is classified as capital expenditure it also has implications for policies set by full Council which were set at the budget meeting in February 2016. It is therefore necessary to amend the following policies discussed in more detail in paras 1.11 to 1.28; • The Council's policy of setting aside funding to repay debt called the

	Minimum Revenue Provision - to incorporate the repayments of the first and second loan and the associated accounting. • The Prudential Code for Capital Finance requires Local Authorities to set a range of Prudential Indicators to demonstrate that their capital investment plans are prudent, sustainable and affordable. These need amending to reflect the inclusion of the loan to NEW Homes. In particular the, authorised limit for debt which is a statutory limit set by the Council which cannot be breached.
1.10	As the loan to NEW Homes is being made to achieve the Council's strategic objectives within the Improvement Plan, it does not meet the definition of an investment within the Council's Treasury Management Strategy. Investments are the use of surplus cash as a result of timing differences between receiving and spending cash to generate a return, with the focus on security, liquidity and finally yield. Therefore there is no need to amend the limits or counterparties in the Investment Strategy within the Treasury Management Strategy 2016/17 and this has been confirmed by the Council's treasury management advisors.
	Minimum Revenue Provision
1.11	Local Authorities are required each year, under the Local Authorities (Capital Finance and Accounting) (Wales) (Amendment) Regulations 2008 ('the 2008 Regulations'), to set aside some of their revenue resources as provision for the repayment of debt.
1.12	Regulation 22 of the 2008 Regulations requires an authority to each year make an amount of Minimum Revenue Provision (MRP) which it considers to be 'prudent', though the regulation itself does not define 'prudent provision'.
1.13	Welsh Government (WG) has provided guidance which makes recommendations to authorities on the interpretation of the term, this guidance was last updated in April 2010.
1.14	Authorities are required to prepare an annual statement of their policy on making MRP.
1.15	The WG guidance provides for a number of options for making 'prudent provision'. It explains that provision for the debt which funded the acquisition of an asset should be made over a period bearing some relation to that over which the asset continues to provide a service.
1.16	As the first loan to NEW Homes is a short term loan of approximately 18 months during the construction phase the recommendation is to make no MRP during this period. This is in line with the Council's current practice for non-current assets that the Council builds funded from prudential borrowing, where MRP is not made during the construction period and begins in the year after the asset has become operational.
1.17	For the second loan to NEW Homes when capital repayments are being made

	the recommended MRP policy is to set the Council's MRP to equal the repayments made by NEW Homes. The repayments made by NEW Homes will be classed in accounting terms as capital receipts, which can only be used to fund capital expenditure or repay debt which is a form of MRP. It is proposed to set aside the capital receipts (the capital repayments) made by NEW Homes to repay debt, being the Council's MRP policy for repaying the loan.
1.18	The Council's current MRP policy for capital expenditure funded from debt under the Prudential system for which no Welsh Government support is being given and is therefore self-financed, is to make provision in equal instalments over the estimated life of the asset for which debt is undertaken. The duration of the second loan is likely to be in the region of 40 years, which broadly equates to the life of the houses being built and therefore the recommended MRP policy is consistent with existing principles the Council has already established.
	Prudential Indicators
1.19	The Prudential Code has been developed by the Chartered Institute of Public Finance & 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.
1.20	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 investment plans of local authorities are affordable, prudent and sustainable.
1.21	The loans to NEW Homes impact on the Prudential Indicators set by the Council in February 2016. There is a need to add the loan to various indicators and demonstrate that the loan does not affect the prudence, affordability or sustainability of the Council's plans. Council are asked to approve the amended Prudential Indicators as set out in paragraphs 1.22 to 1.28 below.
1.22	The prudential indicator for Council Fund capital expenditure needs amending to include the loan payments to NEW Homes.

CAPITAL EXPENDITURE			
	2016/17	**2017/18**	**2018/19**
	Estimate	**Estimate**	**Estimate**
	£m	**£m**	**£m**
Council Fund (as previously set)	21.143	12.301	12.912
Estimated loan to NEW Homes	4.100	3.200	0.100
Revised Council Fund	**25.243**	**15.501**	**13.012**

Note that the HRA estimates have not changed.

1.23	There are 2 prudential indicators for affordability; the ratio of financing costs to net revenue stream, and the estimate of the incremental impact of capital investment decisions on Band D Council Tax and Housing Rents. Neither of these indicators will be affected by the loans to NEW Homes. The interest costs of the first loan will be accrued as a creditor on the Balance Sheet and no MRP will be made therefore there are no associated revenue costs with the first short term loan. The MRP on the second loan will not affect the Council's revenue position, as it will be made through the capital accounts, as explained above in para 1.17. The interest that the Council will pay through the revenue account on the second loan will be more than offset by the marginally higher rate of interest charged and received from NEW Homes, creating a positive impact on the Council's revenue account.
1.24	The prudential indicator estimating the Council Fund's capital financing requirement needs amending to include the loan payments to NEW Homes.

CAPITAL FINANCING REQUIREMENT			
	2016/17	**2017/18**	**2018/19**
	Estimate	**Estimate**	**Estimate**
	£m	**£m**	**£m**
Council Fund (as previously set)	183.554	187.523	189.065
Estimated loan to NEW Homes	4.100	3.200	0.100
Revised Council Fund	**187.654**	**190.723**	**189.165**

	Note that the HRA estimates have not changed. The capital financing requirement measures the Council's underlying need to finance capital expenditure by borrowing or other long-term liability arrangements.
1.25	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'.*
1.26	In the February 2016 Prudential Indicator report The Corporate Finance Manager reported 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. The loan to NEW Homes does not change this position as the Capital Financing Requirement increases in line with gross debt.
1.27	The prudential indicators for external debt need amending to include the loan payments to NEW Homes.

AUTHORISED LIMIT FOR EXTERNAL DEBT			
	2016/17	**2017/18**	**2018/19**
	Estimate	**Estimate**	**Estimate**
	£m	**£m**	**£m**
All Borrowing (as previously set)	299.300	323.300	333.300
Estimated loan to NEW Homes	4.100	3.200	0.100
Revised All Borrowing	**303.400**	**326.500**	**333.400**
Other Long Term Liabilities (previously set)	24.100	25.100	26.100
Revised Total	**327.500**	**351.600**	**359.500**

The authorised limits are consistent with the authority's current commitments, existing plans and the proposals in the capital programme. 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.

Council is asked to note that the authorised limit determined in 2016/17 above will be the statutory limit determined under section 3 (1) of the Local Government Act 2003.

1.28 Council is also asked to approve the operational boundary for external debt for the same period, below. 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.

OPERATIONAL BOUNDARY FOR EXTERNAL DEBT			
	2016/17	**2017/18**	**2018/19**
	Estimate	**Estimate**	**Estimate**
	£m	**£m**	**£m**
All Borrowing (as previously set)	269.300	293.300	303.300
Estimated loan to NEW Homes	4.100	3.200	0.100
Revised All Borrowing	**273.400**	**296.500**	**303.400**
Other Long Term Liabilities (previously set)	9.100	10.100	11.100
Revised Total	**282.500**	**306.600**	**314.500**

2.00	RESOURCE IMPLICATIONS
2.01	As set out within the report.

3.00	CONSULTATIONS REQUIRED / CARRIED OUT
3.01	Arlingclose Ltd – the Council's Treasury Management Advisors.

4.00	RISK MANAGEMENT
4.01	An overall Strategic Risk Register has been established for the SHARP Housing Programme. This is in addition to the scheme specific Risk Register for The Walks which is regularly updated in relation to emerging and changing risks.
4.02	The SHARP team continues to develop a framework for managing risk and opportunities the programme generates. Further work is on-going in order to improve the robustness in risk identification and management as part of the new CAMMS system which will contain Development Framework procedures.
4.03	Decisions made which involve the Council's assets and its Capital Programme often have very large and long term financial implications which carry a variety of risks. This report assess the affordability, prudence and sustainability of the capital plans to manage those associated risks.
4.04	The provision of capital finance to NEW Homes to build housing, is considered fairly low risk as NEW Homes is wholly owned by the Council, the Council exerts a high degree of control over NEW Homes and the Council will register a charge against the new properties as security. The loan also provides a new income stream which could be replicated in future for other strategic priorities.

5.00	APPENDICES
5.01	Appendix 1 – 17th May Cabinet report – SHARP, The Walks Flint – Affordable Housing Development

6.00	LIST OF ACCESSIBLE BACKGROUND DOCUMENTS
6.01	None. **Contact Office:** Liz Thomas

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7.00	**GLOSSARY OF TERMS**
7.01	**Capital Expenditure:** Expenditure on the acquisition of Non-current Assets or expenditure that extends the life or value of an existing asset **Capital Financing Requirement (CFR):** A measure of the capital expenditure incurred historically by an authority that has yet to be financed from capital receipts, capital grants or revenue financing. Council Fund (CF): The fund to which all the Council's revenue and capital expenditure is charged. **Capital Programme** - The Council's financial plan covering capital schemes and expenditure proposals for the current year and a number of future years. It also includes estimates of the capital resources available to finance the programme. **Capital Receipt** - Receipts (in excess of £10,000) from the disposal of an asset **Capital Scheme** - An individual capital project which is monitored and managed in isolation. The aggregate of all schemes comprises the Capital Programme **Council Fund** - The fund to which all the Council's revenue and capital expenditure is charged **Financing** - The process of allocating resources to meet the cost of capital expenditure, which can be done on a project, asset or whole programme basis. This contrasts with making the invoice payments relating to capital expenditure, which should be managed within the authority's overall treasury management policy **Housing Revenue Account (HRA):** The fund to which all the Council's revenue and capital expenditure relating to its housing stock is charged. **Minimum Revenue Provision (MRP):** A charge made to the Council Fund to repay borrowing taken out for capital expenditure. Authorities must determine their own prudent MRP charge each year, taking into consideration statutory guidance issued by the Government. **Non-current Asset** - A resource controlled (but not necessarily owned) by an authority, from which economic benefits or service potential are expected to flow to the authority for more than 12 months **North East Wales Homes, (NEW Homes)** - is a Housing company based in Flintshire and owned by Flintshire County Council. NEW Homes owns, leases and manages properties across Flintshire. The company was

	established to increase the quantity and quality of affordable housing available across the county; increasing housing choice for those who may not qualify for social housing but for whom market housing is unaffordable or difficult to access. **Prudential Code:** The code of practice drawn up by the Chartered Institute of Public Finance and Accountancy (CIPFA) to underpin the requirements of the Local Government Act 2003 in respect of an authority's duty to determine the affordability, prudence and sustainability of its capital investment needs. **Prudential Indicators** - Required by the **Prudential Code**, these take the form of limits, estimates or actual figures used to support the local decision making process for capital investment **Revenue Expenditure:** All expenditure incurred by an authority that cannot be classified as capital expenditure. **Revenue Support Grant (RSG):** Is paid to each authority to cover the cost of providing standard services less the Council Tax income at the standard level. **Strategic Housing And Regeneration Programme (SHARP)** – Flintshire County Council House Building Programme which will build 500 new homes (200 Council) and 300 (affordable). **Unhypothecated Supported Borrowing (USB), commonly referred to as Supported Borrowing:** Each year Welsh Government provide Council's with a Supported Borrowing allocation. Council's borrow to fund capital expenditure equivalent to that annual allocation, Welsh Government then include funding to cover the revenue costs associated with the borrowing for future years within the Revenue Support Grant. The Council decides how this funding is spent**.** **Unsupported Prudential Borrowing:** Borrowing administered under the Prudential Code, whereby authorities can set their own policies on acceptable levels and types of borrowing. The Prudential Framework allows authorities to take out loans in response to overall cash flow forecasts and other factors provided they can show that the borrowing is to meet planned capital expenditure in the current year or the next three years.