CABINET MEETING

Date of Meeting	Tuesday 14 February 2017
Report Subject	Prudential Indicators 2017/18 - 2019/20
Cabinet Member	Leader of the Council and Cabinet Member for Finance
Report Author	Chief Executive and Corporate Finance Manager
Type of Report	Operational

EXECUTIVE SUMMARY

Under the Prudential Code for Capital Finance in Local Authorities (the Prudential Code), authorities are required to set a range of Prudential Indicators (PI's). This report provides details of the Council's Prudential Indicators for 2017/18 – 2019/20:

- Prudential Indicators for Capital Expenditure
- Prudential Indicators for Affordability
- Prudential Indicators for Prudence
- Prudential Indicators for External Debt and Treasury Management

RECOMMENDATIONS	
1	That members approve and recommend to the County Council on 14 February 2017:- • The Prudential Indicators for 2017/18 - 2019/20 as detailed in Section 1 of the report. • 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 (1.19 - 1.20).

REPORT DETAILS

1.00	**EXPLAINING THE PRUDENTIAL INDICATORS**
1.01	**Background** 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.
1.02	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 investment plans of local authorities are **affordable, prudent and sustainable**, and that treasury management decisions are taken in accordance with good professional practice.
1.03	The Prudential Code sets out the indicators that must be used, and the factors that must be taken into account in preparing such.
1.04	**Considerations** 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.
1.05	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 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.

1.06	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.
1.07	The Prudential Code specifies that prudential indicators are required to be calculated for the forthcoming financial year and 2 subsequent financial years.
	Housing Revenue Account (HRA)
1.08	As reported to Cabinet previously, the Council along with all other Welsh Councils, exited the HRA negative subsidy system in 2015/16, the final sum payable, to HM Treasury via Welsh government (WG), was £79.248m. This has released revenue savings into the HRA which has allowed the Council to invest in upgrading its existing stock and to increase the supply of social housing in the county.
	Prudential Indicators for Capital Expenditure
1.09	Based on those resources currently allocated (including specific grants, but excluding any rephasing of expenditure from 2016/17 to future years), the estimates of capital expenditure to be incurred in 2017/18 (and the following two years), are as indicated in Table 1 below.

Table 1

CAPITAL EXPENDITURE				
	2016/17	**2017/18**	**2018/19**	**2019/20**
	Estimate	**Estimate**	**Estimate**	**Estimate**
	£m	**£m**	**£m**	**£m**
Council Fund	25.243	19.435	18.586	11.214
Housing Revenue Account	25.933	27.744	25.712	24.920
Total	**51.176**	**47.179**	**44.298**	**36.134**

1.10	This is in line with the capital programme proposals in the Council Fund Capital Programme – 2017/18 – 2019/20 report and the HRA budget report which are included elsewhere on this agenda.
1.11	The capital expenditure totals essentially provide the base financial data from which all other indicators follow.

Prudential Indicators for Affordability

1.12 Estimates of the ratio of financing costs to net revenue stream for 2017/18 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 Table 2 below; these indicators of affordability address the revenue implications of the Council's financial strategy.

Table 2

RATIO OF FINANCING COSTS TO NET REVENUE STREAM				
	2016/17	**2017/18**	**2018/19**	**2019/20**
	Estimate	**Estimate**	**Estimate**	**Estimate**
	%	**%**	**%**	**%**
Council Fund	6.1%	5.1%	5.2%	5.2%
Housing Revenue Account	24.6%	25.2%	25.9%	25.6%

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.

1.13 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 a number of new capital schemes which invest in assets and / or reconfigure models of service provision, over and above decisions taken in previous years. They are pivotal to support the delivery of the Council's strategic priorities outlined in portfolio business plans and the Improvement Plan.

1.14 At the present time there is an overall shortfall in projected general capital funding, with specific shortfalls in 2018/19 and 2019/20. To meet this shortfall the Council will potentially have to borrow to fund the schemes which would increase revenue costs, the incremental impact of which on Band D Council Tax is shown in Table 3 below.

The Council's intention is to fund the shortfall from a combination of future capital receipts, alternative grants, and by phasing schemes overall several years. Borrowing would therefore be used as a last resort and therefore the estimates in Table 3 represent the worst case scenario.

Table 3

ESTIMATED INCREMENTAL IMPACT OF CAPITAL INVESTMENT			
	2017/18	**2018/19**	**2019/20**
	Estimate	**Estimate**	**Estimate**
	£	**£**	**£**
Council Fund	0.00	1.44	2.52
Housing Revenue Account	Nil	Nil	Nil

The HRA Capital Programme contains no new capital expenditure decisions, over and above the 30 year Business Plan which was approved by Council in 2016/17 including upgrading existing housing stock to Welsh Housing Quality Standards, and building new social housing.

Prudential Indicators for Prudence

1.15 Estimates of the capital financing requirement, for 2017/18 are shown in Table 4 below:

Table 4

CAPITAL FINANCING REQUIREMENT				
	2016/17	**2017/18**	**2018/19**	**2019/20**
	Estimate	**Estimate**	**Estimate**	**Estimate**
	£m	**£m**	**£m**	**£m**
Council Fund	187.654	208.091	214.154	217.441
Housing Revenue Account	112.202	120.711	129.650	135.817
Total	**299.856**	**328.803**	**343.804**	**353.259**

1.16	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. 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.
1.17	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'.* The purpose of the indicator is to ensure authorities are only borrowing in the medium to long term for capital purposes.
1.18	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.
1.19	**Prudential Indicators for External Debt and Treasury Management** In respect of its external debt, it is recommended that the Council approves the authorised limits shown in Table 5 overleaf 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.

Table 5

AUTHORISED LIMIT FOR EXTERNAL DEBT				
	2016/17	2017/18	2018/19	2019/20
	Estimate	Estimate	Estimate	Estimate
	£m	£m	£m	£m
All Borrowing	303	340	346	352
Other Long Term Liabilities	24	35	35	35
Total	**328**	**375**	**381**	**387**

The authorised limits are consistent with the Council's current commitments, existing plans and the proposals in the capital programme report, and with its approved Treasury Management Strategy 2017/18. 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.

1.20 Council is also asked to approve the operational boundary for external debt for the same period, shown in Table 6. 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.

Table 6

OPERATIONAL BOUNDARY FOR EXTERNAL DEBT				
	2016/17	2017/18	2018/19	2019/20
	Estimate	Estimate	Estimate	Estimate
	£m	£m	£m	£m
All Borrowing (Cap/Rev)	273	320	326	332
Other Long Term Liabilities	9	20	20	20
Total	**283**	**340**	**346**	**352**

1.21	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 2017/18 (see section 1.18 above) will be the statutory limit determined under section 3 (1) of the Local Government Act 2003.

2.00	**RESOURCE IMPLICATIONS**
2.01	There are no resource implications as a result of this report.

3.00	**CONSULTATIONS REQUIRED / CARRIED OUT**
3.01	No consultation is required or carried out.

4.00	**RISK MANAGEMENT**
4.01	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.

5.00	**APPENDICES**
5.01	None.

6.00	**LIST OF ACCESSIBLE BACKGROUND DOCUMENTS**
6.01	Various Welsh Government papers. **Contact Officer:** Liz Thomas - Finance Manager, Technical Accountancy **Telephone:** (01352) 702289 **E-mail:** liz.thomas@flintshire.gov.uk

7.00	**GLOSSARY OF TERMS**
7.01	**Asset Management Plan** - A plan maintained by an authority of the condition and suitability of its assets, updated regularly and utilised to assess future capital needs **Capital Expenditure** - Expenditure on the acquisition of **Non-current Assets** or expenditure that extends the life or value of an existing asset **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** **Capital Strategy** - A corporate document providing clear strategic guidance about an authority's objectives, priorities and spending plans, demonstrating the link to key corporate and service objectives. May be combined with the **Asset Management Plan (AMP)** to from a single document **Council Fund** - The fund to which all the Council's revenue and capital expenditure is charged **Disposal** - The decommissioning or transfer of an asset to another party **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 **General Capital Grant -** Annual capital grant from Welsh Government which the Council decides how to use the funding. **Housing Revenue Account -** The fund to which all the Council's revenue and capital expenditure relating to its housing stock is charged. **Local Government Borrowing Initiative (LGBI) -** Similar to **supported borrowing**. In recent years as Welsh Government funding has been under pressure, schemes that would have been funded by capital grant have been funded by LGBI. Welsh Government provides the revenue support for borrowing costs incurred by the Council in borrowing to fund capital schemes (the difference with supported borrowing being that it's for a specific purpose aligned to Welsh Government priorities). LGBI has recently been used for highways maintenance and is now being used to part fund the Welsh Government element of the 21st century schools programme. **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

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 Financing - Charges made to the revenue account to finance capital expenditure. May also be referred to as Capital Expenditure charged to Revenue Account (CERA).

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

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.