

Committee/Meeting: Cabinet	Date: 10th February 2010	Classification: Unrestricted	Report No: (CAB 115/090)
Report of: Corporate Director of Resources Originating officer(s) Alan Finch: Service Head – Corporate Finance Oladapo Shonola: Chief Financial Strategy Officer		Title: 2010/11 Prudential and Treasury Indicators Wards Affected: All	

Lead Member	Cllr Ohid Ahmed – Resources and Performance
Community Plan Theme	All
Strategic Priority	One Tower Hamlets

1 SUMMARY

- 1.1 The Council is required to set prudential indicators by the Local Government Act 2003 and the Local Authorities (Capital Financing and Accounting) Regulations 2003.
- 1.2 The prudential indicators underpin the Council’s investment plans and demonstrate that they are financially prudent, affordable and sustainable. These indicators are also used to monitor and regulate the decision making process for treasury management activity within the Council.
- 1.3 The Council’s Capital Strategy ensures that the use of capital resources is optimised by allocating funding to those programmes or projects that contribute most to the objectives set out in the Strategic Plan.
- 1.4 It is a statutory requirement under section 33 of the Local Government Finance Act 1992 for the Council to produce a balanced budget. In particular, Section 32 requires a local authority to calculate its budget requirement for each financial year to include the revenue costs that flow from capital financing decisions. This means that capital expenditure must be limited to a level whereby increases in charges to revenue from:
- Interest charges caused by borrowing to finance additional capital expenditure; and
 - Running costs for new capital projects are affordable, sustainable and prudent.
- 1.5 The indicators in this report are derived from borrowing and resource projections and spending decisions already taken, and also reflect proposals presented to 13 January 2010 Cabinet. They establish limits on the amount of borrowing the Council can undertake in the medium term and demonstrate that such borrowing will not over-commit subsequent years’ revenue budgets.

- 1.6 The Regulations require that Prudential Indicators be adopted by Full Council and the indicators recommended by Cabinet will be considered by Council at its meeting on the 3 March 2010.
- 1.7 Developments which take place after consideration by Cabinet could necessitate revision of the indicators before they are adopted by Council and consequently it is recommended that the Corporate Director of Resources be authorised to adjust the figures prior to consideration by Council. The Prudential Indicators as set by the Council on 3 March 2010 will apply throughout the financial year and can only be changed by reference to Full Council.

2 DECISIONS REQUIRED

Cabinet is recommended to:-

- 2.1 Agree the Operational Boundaries for External Debt set out in section 10.3 of this report and recommend that they be adopted by Council:
- 2.2 Agree the Authorised Limits for External Debt set out in section 10.3 of this report and recommend that they be adopted by Council:
- 2.3 Agree the prudential indicators set out in sections 8 – 11 of this report as required under the Prudential Borrowing Code and recommend that they be agreed by Council:-
- 2.4 Authorise the Director of Corporate Resources after consultation with the lead Member for Resources and Performance to revise the indicators as set out in recommendations 2.1 to 2.3 of this report to reflect any developments between the meetings of Cabinet on 10 February 2010 and Full Council on 3 March 2010.

3 REASONS FOR THE DECISIONS

- 3.1 The Council is required to set prudential indicators by the Local Government Act 2003 and the Local Authorities (Capital Financing and Accounting) Regulations 2003.
- 3.2 The prudential indicators underpin the Council's investment plans and demonstrate that they are financially prudent, affordable and sustainable. These indicators are also used to monitor and regulate the decision making process for treasury management activity within the Council.

4 ALTERNATIVE OPTIONS

- 4.1 The Council is bound by legislation to have regard to the Prudential Code in designing its capital investment programme and financing of such capital programmes. The Council is required to set and review specific prudential indicators on an annual basis and this report presents the 2010/11 prudential indicators.
- 4.2 If the Council were to deviate from those requirements, there would need to be some good reason for doing so. It is not considered that there is any such reason, having regard to the need to ensure that the Council's capital investment plans are affordable, sustainable and prudent and that treasury management decisions are taken in line with good professional practice.

5 BACKGROUND

- 5.1 The Prudential Code provides Councils with discretion to determine their own levels of borrowing, subject to such borrowing being affordable, sustainable and prudent. This effectively enables Councils to set their own levels of capital expenditure, subject to there being scope within revenue budgets to finance any associated debt charges.
- 5.2 Prudential borrowing is at the discretion of individual local authorities and the associated debt charges do not attract corresponding Government grant and consequently must be funded locally. Current policy, as set out in the Capital Strategy is that unsupported borrowing may only be used for projects which can effectively self-fund by either raising sufficient revenue income or by reducing revenue costs so as to be able to fund the attributable finance charges.
- 5.3 The principal constraint on the level of capital investment by individual Councils is the scope to finance the associated loan charges within revenue budgets. To ensure Councils do not over-commit their revenue budgets the Government requires Councils to calculate and adopt a number of indicators to demonstrate that their investment programmes are financially prudent. The main benefit to Councils from the system is greater flexibility to determine relative spending for capital and revenue purposes, and increased discretion over when investment will take place.

6 THE PRUDENTIAL CODE

- 6.1 Prudential Indicators are part of an integrated financial strategy and budgeting regime, which regulates the activities of the Council.
- 6.2 This approach involves the Council establishing its medium term objectives within the Community and Strategic Plans. The Financial Outlook and Review and the Capital Strategy documents determine the contribution which revenue and capital expenditure can make towards the achievement of these objectives within projected resource constraints.

- 6.3 The annual revenue and capital budgets determine how the objectives identified within community and strategic plans are to be implemented.
- 6.4 Prudential indicators are a control mechanism within this process, which ensure that projections within the capital budgets are consistent with those within the revenue budgets. The Prudential indicators essentially ensure that overall levels of debt are affordable and that adequate provision for the debt charges and any other revenue costs associated with the Capital Programme exists within the revenue budgets.
- 6.5 In considering its programme for capital investment, the Council is required within the Prudential Code to have regard to:
- Stewardship of assets, e.g. asset management planning
 - Service objectives, e.g. strategic planning for the authority
 - Affordability, e.g. implications for Council Tax / Housing Rents
 - Prudence and sustainability, e.g. implications for long term external borrowing
 - Value for money, e.g. option appraisal
 - Practicality, e.g. achievability of the forward plan.
- 6.6 The Prudential Code also emphasises that local authorities must have effective risk identification and management arrangements in place to cover eventualities that may occur over the lifetime of their capital programmes including:
- delays in securing capital receipts or grants;
 - anticipated future savings and revenue funding targets not being achieved, or
 - Project management problems.
- 6.6 The detailed provisions relating to the system were developed by the Chartered Institute of Public Finance and Accountancy (CIPFA). CIPFA have identified a number of indicators for Chief Financial Officers to calculate, which when taken together will satisfy the requirements of the Prudential Borrowing System.

7 THE PROCESS

- 7.1 There are two categories of borrowing available to finance capital investment:
- Supported borrowing and
 - Unsupported borrowing
- 7.2 Supported borrowing occurs when the Government reimburses individual Councils for the loan charges associated with an assumed level of borrowing. The assumed level of borrowing corresponds to the Government's assessment of how much a Council needs to invest to achieve national targets and priorities for individual Council services. However, since the Council's Formula Grant is currently at the grant floor, it cannot be taken as read that Formula Grant provides adequate funding for supported borrowing.

7.3 The projected supported borrowing allocation for 2010/11 is set out in table 1.

Table 1

Supported Capital Expenditure	2010/11
	£m
Housing	15.000
Children Services	5.821
Total	20.821

7.4 Unsupported borrowing (otherwise known as 'Prudential Borrowing') occurs when the loan charges associated with the Council's capital investment do not receive financial support by the Government and consequently are entirely financed by either by an increase in the Council Tax, a corresponding reduction in other revenue budgets, or additional income.

7.5 Unsupported borrowing reflects local rather than national priorities and projects funded by prudential borrowing form a part of the financing package for Local Priorities Capital Programme.

7.6 The Code requires that the Council develop a framework to ensure that an integrated approach is adopted with regard to the revenue and capital budgeting processes. In particular it must show that the revenue costs associated with the capital investment programmes are consistent with the relevant revenue budgets.

7.7 The borrowing relates to ongoing projects which were approved in prior years' capital programmes. Other projects may be identified which meet the Council's criteria for Prudential Borrowing as set out in the Council's Capital Strategy. Such projects may be adopted and similarly funded in future years subject to the operational limits for external debt and the impact on available funding.

8 THE PRUDENTIAL INDICATORS

8.1 There are three categories of indicators under the Prudential Code stipulated

- The Prudential Indicators relating to Capital Investment
- The Prudential Indicators for External Debt
- The Prudential Indicators relating to Treasury Management.

9 THE PRUDENTIAL INDICATORS RELATING TO CAPITAL INVESTMENT

9.1 This set of indicators assesses the affordability of the Council's capital investment plans. The indicators assess the impact on the revenue budgets by determining the Council's expenditure plans and then calculating the proportion of revenue resources which will be required to provide finance for the associated loan charges and the potential increase in Council Tax levels.

- 9.2 The actual capital expenditure that was incurred in 2008/09 and the estimates of capital expenditure to be incurred for the current and future years are as set out in Table 2:

Table 2

Capital Expenditure	2008/09	2009/10	2010/11	2011/12	2012/13
	Actual	Probable Outturn	Estimate	Estimate	Estimate
	£M	£M	£M	£M	£M
Housing	31.315	39.917	36.598	29.836	27.911
Adult Services	0.286	0.387	0.392	0.000	0.000
Children's Services	11.300	17.730	17.910	0.000	0.000
Communities Localities and Culture	7.316	7.081	2.900	3.000	3.000
Development & Renewal	0.261	3.500	0.890	0.200	0.200
Local Priorities Programme	11.454	22.579	46.048	5.133	19.833
Total	61.932	91.194	104.738	38.169	50.944
Represented by:-					
HRA	31.315	39.917	36.598	29.836	27.911
General Fund	30.617	51.277	68.140	8.333	23.033
Total	61.932	91.194	104.738	38.169	50.944

- 9.2 The ratio of financing costs to net revenue stream sets out the loan charges associated with capital expenditure as a proportion of the income received by the Council in the form of Council Tax and Government grants. Where this indicator increases over time, it can be inferred there will be a greater relative commitment of revenue budgets in the medium term, which will in turn constrain the scope to adjust budgets in those years. Estimates of the ratio of financing costs to net revenue stream for the current and future years, and the actual figures for 2008/09 are as set out in Table 3:

Table 3

Ratio of Financing Costs to Net Revenue Stream	2008/09	2009/10	2010/11	2011/12	2012/13
	Actual	Probable Outturn	Estimate	Estimate	Estimate
Non HRA	1.38%	2.90%	2.96%	3.08%	3.27%
HRA	16.10%	17.34%	18.82%	21.50%	24.29%

- 9.3 The Capital Financing requirement represents the underlying need of the Council to borrow for capital purposes. In practice this is the existing borrowing requirement plus the incremental investment funded by borrowing required in each of the following years, reduced by debt repayment. Estimates of the end of year capital financing requirement for the authority for the current and future years and the actual capital financing requirement at 31 March 2009 are as set out in Table 4. The Code requires Councils with a Housing Revenue Account (HRA) to identify the Capital Financing Requirement relating to HRA assets separately.

Table 4

Capital Financing Requirement	2008/09	2009/10	2010/11	2011/12	2012/13
	Actual	Estimate	Estimate	Estimate	Estimate
	£M	£M	£M	£M	£M
HRA	261.480	276.480	301.075	316.075	331.075
General Fund	160.218	161.570	160.784	159.353	157.979
Total	421.698	438.050	461.859	475.428	489.054
Annual Change in Financing Requirement					
Annual Change in Financing Requirement	2008/09	2009/10	2010/11	2011/12	2012/13
	Actual	Estimate	Estimate	Estimate	Estimate
	£M	£M	£M	£M	£M
HRA	-39.737	15.000	24.595	15.000	15.000
General Fund	3.016	1.352	-0.786	-1.431	-1.374
Total	-36.721	16.352	23.809	13.569	13.626

- 9.4 It should be recognised that the Council has to borrow both to provide temporary finance for its revenue transactions and for capital purposes. The Council 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 can be 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. In contrast, the capital financing requirement reflects the authority's underlying need to borrow for a capital purpose.
- 9.5 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 net external borrowing does not, except in the short term, exceed the total of capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years."
- 9.6 The Council had no difficulty meeting this requirement in 2008/09, nor are any difficulties envisaged for the current or future years. This view takes into account current commitments, existing plans, and the proposals in this year's budget report.
- 9.7 A key measure of affordability is the impact of capital investment decisions on the Council Tax and Rent. This is as set out in Table 5.

Table 5

Incremental Impact of capital investment decisions	2008/09	2009/10	2010/11	2011/12	2012/13
	Actual	Estimate	Estimate	Estimate	Estimate
Increase in council tax (band D) per annum	£19.57	£8.46	£5.77	£2.87	£8.09
Increase in average housing rent per week	£0.00	£0.00	£0.00	£0.00	£0.00

9.8 The Council Tax figures in the table are based on the gross borrowing costs of both discretionary and supported capital expenditure. While the Council's Formula Grant is at the grant floor, no additional funding is provided for capital borrowing.

10 THE TREASURY INDICATORS FOR EXTERNAL DEBT

10.1 The Prudential Indicators relating to external debt set out the maximum level of debt the Council can borrow consistent with its capital expenditure plans and the parameters within which the Corporate Director of Resources can undertake borrowing under delegated authority.

10.2 The CIPFA Code requires Councils to determine the maximum level of external debt and other long-term liabilities for the current and succeeding three financial years.

10.3 The Corporate Director of Resources has calculated the limits on the basis of an estimate of the most likely, prudent, but not worst case scenario, with a contingency sum to cover unforeseen eventualities. The increase is necessary to provide sufficient scope for potential borrowing relating to treasury management activity and alternative financing for existing financial arrangements. The limits are set out in Table 6:

Table 6

Authorised Limit for External Debt	2008/09	2009/10	2010/11	2011/12	2012/13
	Actual	Estimate	Estimate	Estimate	Estimate
	£M	£M	£M	£M	£M
Borrowing	465.000	515.000	565.000	595.000	615.000
Other Long Term Liabilities	0.000	0.000	0.000	0.000	0.000
Total	465.000	515.000	565.000	595.000	615.000
Operational Boundary for External Debt					
Operational Boundary for External Debt	2008/09	2009/10	2010/11	2011/12	2012/13
	Actual	Estimate	Estimate	Estimate	Estimate
	£M	£M	£M	£M	£M
Borrowing	445.000	495.000	545.000	575.000	595.000
Other Long Term Liabilities	0.000	0.000	0.000	0.000	0.000
Total	445.000	495.000	545.000	575.000	595.000

10.4 The Corporate Director of Resources is required to obtain Council approval to subsequently revise the Authorised Limit.

10.5 In taking its decisions on this report, the Council is asked to note that the authorised limit determined for 2010/11 will be the statutory limit determined under [clause] 3(1) of the Local Government Act 2003.

10.6 The Code also requires the Council to set an operational boundary for external debt for the same time period. The Operational Boundary differs from the Authorised Limit for external debt in that it excludes the contingency sum and it can be exceeded without requiring the approval of Council. The operational boundary represents a key management tool for in-year monitoring by the Chief Finance Officer.

11 THE PRUDENTIAL INDICATORS RELATING TO TREASURY MANAGEMENT

11.1 This category of indicator regulates the additional borrowing which may be undertaken to ensure that it is based on financially sound principles and minimises the risk associated with adverse movements in interest rates.

11.2 The Prudential Code requires that the Council sets a number of indicators to set the parameters within which the Chief Finance Officer can undertake treasury related transactions under delegated authority.

11.3 It is recommended that the Council sets a maximum level of 100% for its fixed interest rate exposure and a maximum variable rate exposure limit of 20%. This will enable the Corporate Director of Resources to manage fixed interest exposures within the range 80% to 100% and variable rate within the range 0% to 20% of net outstanding principal sums.

11.4 It will be necessary for the Council to undertake additional borrowing to finance both capital expenditure and debt maturities. To minimise the Council's potential exposure to adverse movements in interest rates the debt portfolio is managed to ensure that debt matures evenly throughout the debt term. It is recommended that the Council sets upper and lower limits for the maturity structure of its borrowings as set out in Table 7.

Table 7

Debt Maturity Profile	Upper limit	Lower limit
under 12 months	10%	0%
12 months and within 24 months	25%	0%
24 months and within 5 years	25%	0%
5 years and within 10 years	90%	0%
10 years and above	100%	0%

11.5 There are no proposals for the Council to invest sums for periods longer than 364 days

12 COMMENTS OF THE CHIEF FINANCIAL OFFICER

12.1 The comments of the Chief Financial Officer have been incorporated into this report.

13 CONCURRENT REPORT OF THE ASSISTANT CHIEF EXECUTIVE (LEGAL SERVICES)

- 13.1 The Local Government Act 2003 provides a framework for the capital finance of local authorities. It provides a power to borrow and imposes a duty on local authorities to determine an affordable borrowing limit. It provides a power to invest. Fundamental to the operation of the scheme is an understanding that authorities will have regard to proper accounting practices recommended by the Chartered Institute of Public Finance and Accountancy (CIPFA) in carrying out capital finance functions.
- 13.2 The Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 require the Council to have regard to the CIPFA publication "Prudential Code for Capital Finance in Local Authorities" ("the Prudential Code") when carrying out its duty under the Act to determine an affordable borrowing limit. The Prudential Code specifies a minimum level of prudential indicators required to ensure affordability, sustainability and prudence. The report properly brings forward these matters for determination by the Council. If after having regard to the Prudential Code the Council wished not to follow it, there would need to be some good reason for such deviation.
- 13.3 The Local Government Act 2000 and regulations made under the Act provide that adoption of a plan or strategy for control of a local authority's borrowing, investments or capital expenditure, or for determining the authority's minimum revenue provision, is a matter that should not be the sole responsibility of the authority's executive and, accordingly, it is appropriate for the Cabinet to agree these matters and for them to then be considered by full council.

14 ONE TOWER HAMLETS CONSIDERATIONS

- 14.1 Use of the Prudential Borrowing facility will provide flexibility in the Council's capital investment to achieve the corporate objectives. Setting the prudential indicator is a statutory pre-condition of exercising the discretion

15 SUSTAINABLE ACTION FOR A GREENER ENVIRONMENT

- 15.1 There are no sustainable actions for a greener environment implications arising from this report.

16 RISK MANAGEMENT IMPLICATIONS

- 16.1 The Prudential Code attempts to address the potential risks inherent in granting Councils discretion to determine their own level of capital expenditure and associated borrowing.
- 16.2 The indicators ensure that Members are aware of the implications of the capital expenditure decisions taken on the revenue budgets to determine if they are affordable.

- 16.3 The Council has restricted its Prudential Borrowing to levels at which the associated loan charges are financed by either Formula Grant or a compensating reduction in revenue budgets.
- 16.4 This ensures that the impact of the borrowing on revenue budgets is broadly neutral.

17 CRIME AND DISORDER REDUCTION IMPLICATIONS

- 17.1 There are no crime and disorder reduction implications arising from this report.

18 EFFICIENCY STATEMENT

- 18.1 The evaluation process for projects includes criteria for the delivery of efficiency improvements within the Council, prior to the adoption of capital estimates being approved.

19 APPENDICES

None

**Local Government Act, 1972 Section 100D (As amended)
List of “Background Papers” used in the preparation of this report**

Brief description of “background papers”	Name and telephone number of holder and address where open to inspection.
Directorate Bids Treasury Estimate Papers	Oladapo Shonola (x4733), Chief Financial Strategy Officer, 4 th Floor Mulberry Place