AGENDA ITEM NO. 6

TAUNTON DEANE BOROUGH COUNCIL

EXECUTIVE 14 JANUARY 2004

REPORT OF THE HEAD OF FINANCE
This Matter Is The Responsibility of Executive Cllr Williams (Leader of the Council)

THE PRUDENTIAL CODE

1 Executive Summary

1.1 The Prudential Code will become effective on the 1 April 2004, the indicators prescribed by the Code will therefore have to be considered as part of the 2004/05 budget setting process.

1.2 In preparation for the implementation of the Code, the Councils treasury management advisors, Sector, have been asked to give presentations to the Executive on the impact of the Code and also to undertake an analysis of the Councils Balance Sheet to assist officers in the preparation of the indicators.

1.3 The Executive is requested to note the contents of this report and to approve the Prudential Indicators.

2 Background

2.1 At the December Executive (10th December 2003) a report was presented outlining the key requirements of the Prudential Code (the Code) and setting out the indicators that will have to be set by the Council under the Code.

2.2 In preparation for the full implementation of the Code on 1st April 2004 Sector, the Councils Treasury Management Advisors, have agreed to attend both the agenda setting meeting on the 5th January 2004 and the Executive meeting on the 14th January 2004 to explain the implications of the code. Sector have also been asked to carry out an analysis of the Councils Balance Sheet to assist officers in the calculation of the Prudential Indicators and to ensure that the Council is able to take advantage of any freedoms provided within the Code.

2.3 For the purposes of this report indicators have been produced using information currently available either from the 2003/04 Budget Book or the 2002/03 Statement of Accounts.

3 The Indicators for 2004/5 and 2005/6

Each of the indicators required under the Code is detailed below together with the estimated indicator for 2004/5 and 2005/6:

3.1 Indicator 1: The local authority will make reasonable estimates of the total of capital expenditure that it plans to incur during the forthcoming financial year and at least the following two financial years.

3.1.1 This is the first indicator linked to affordability and sets out the Councils expected capital expenditure over the next three years. The 2002/03 budget book identifies programmed capital schemes and subsequent years capital needs. The estimates of capital expenditure to be incurred are therefore;

Year	General Fund	HRA	Total
2003/04	£3,230,730	£3,986,600	£7,217,330
2004/05	£523,100	Unknown	£523,100
2005/06	£313,100	Unknown	£313,100

3.1.2 The figures shown above do not reflect any of the decisions which have been made by the Executive during the 2004/05 budget setting process as this has yet to be formally approved by Full Council, this indicator will be amended when this approval takes place in February. The Council has a history of setting a medium term capital programme for General Fund services, thereby complying with this indicator, however the current capital planning process for the Housing Revenue Account tends to focus on the short term only, thereby making it difficult to accurately forecast future capital expenditure. It is envisaged that for the forthcoming year, to comply with the Indicator, a medium term capital programme will be produced for the HRA.

3.2 Indicator 2: The local authority will make reasonable estimates of the total capital financing requirement at the end of the forthcoming financial year and the following two years.

3.2.1 The estimated Capital Financing Requirement is;

2003/04 - £25,310,870
2004/05 - £22,439,847
2005/06 - £23,100,695

The capital financing requirement is a measure of the Council’s underlying need to borrow money long term and is comparable in certain respects to the current credit ceiling (the Credit ceiling is a notional figure which represents our actual overall level of debt). The figures above include both General Fund and HRA. At the end of each financial year the actual capital financing requirement will be calculated directly from the Council’s balance sheet.

3.2.2 Local authorities have available to them a number of ways of financing capital investment. In all cases cash will be paid out, the term “financing” does not refer to the payment of cash but the resources that are used to pay for schemes. A number of financing options are available to local authorities, these include;

- The application of useable capital receipts
- A direct charge to revenue
- Application of a capital grant

- Contributions received from another party

Capital expenditure that is not financed by one of these methods will increase the Capital Financing Requirement of the Council, ie there will be a need to increase borrowing.

3.2.3 In summary, the Capital Financing Requirement will increase whenever capital expenditure is incurred. Where the expenditure is resourced immediately (from one of the methods mentioned in 3.2.2) then the Capital Financing Requirement will subsequently reduce resulting in no net increase to the indicator.

3.3 Indicator 3: The local authority will set for the forthcoming financial year and the following two financial years a prudential limit for its external debt, gross of investments, separately identifying borrowing from other long term liabilities. The prudential indicator shall be referred to as Authorised limit for external debt.

3.3.1 The current authorised limits for external debt is as follows;

2003/04 - £44m
2004/05 - £44m
2005/06 - £44m

This limit represents the maximum amount the Council may borrow at any point in time in the year and has to be set at a level the Council considers to be "prudent". This limit is currently set each year and is contained in the Treasury Management Strategy. Actual external debt at the 31 March 2003 was £22,142,159.

3.4 Indicator 4:The local authority will also set for the forthcoming financial year and the following two years an operational boundary for its total external debt.

3.4.1 The estimated operational boundary for borrowing is;

2003/04 - £30m
2004/05 - £30m
2005/06 - £30m

The operational boundary is a measure of the most money the Council would borrow at any time during the year. The code recognises that circumstances might arise when the boundary might be exceeded temporarily but suggests a sustained or regular pattern of borrowing above this level should be investigated as a potential symptom of a more serious financial problem. As mentioned in 3.3.1 the current level of debt outstanding stands at £22,142,159 and it would be unlikely for the council to exceed either the operational boundary or the authorised limit for external debt. The Council will work with its Treasury Management advisors to ensure that the Council only holds debt at an appropriate level.

3.5 Indicator 5: After the year end the closing balance for actual gross borrowing plus other long term liabilities will be obtained directly from the authority' s balance sheet.

3.5.1 The predicted closing balance for gross borrowing is as follows;

2003/04	£22,041,992
2004/05	£20,531,227
2005/06	£19,020,166

The above indicators assume that borrowing will reduce in line with the conditions of loans from the PWLB over the next three years, the current capital programme contains only minor need for further borrowing.

The Net borrowing position of the Council as at 31 March 2003 was £8,692,159, calculated by taking the outstanding debt figure (£22,142,159) less the sum of investments held (£13,450,000).

3.6 Indicator 6: Has the local authority adopted the CIPFA Code of Practice for Treasury Management in Public Services

3.6.1 This indicator is linked to the concept of Prudence and ensures the council's investment decisions are being made in line with the CIPFA code of practice. The Council has adopted this code of practice and Treasury Management Practices (TMP's) have been established by the Head of Finance.

3.7 Indicator 7: The local authority will set for the forthcoming year and the following two years, both upper and lower limits for its variable interest rate exposure.

3.7.1 The upper limit has been set at 50% and is contained within the TMP's (section 1.2.3) and by definition the lower limit is 0%.

3.8 Indicator 8: The local authority will set for the forthcoming year and the following two years, both upper and lower limits for its exposure to fixed interest rate risk.

3.8.1 The limits proposed are as follows;

Upper limit	100%
Lower Limit	50%

The upper limit has been agreed by Council as part of the annual borrowing limits, the lower limit is effectively the counterpart to the upper limit for variable rate exposure (indicator 7).

3.9 *Indicator 9: The local authority will set for the forthcoming year both upper and lower limits with respect to the maturity structure of its borrowing.*

3.9.1 The majority of the Councils debt is repayable at the date of maturity. The current maturity structure of the Councils borrowing is as follows;

Maturity	Amount	% of Total Borrowing
Up to 1 year	£10,475	0.04%
1 – 2 Years	£1,510,764	6.82%
2 – 5 Years	£4,532,971	20.47%
5 – 10 Years	£3,522,282	15.9%
Over 10 Years	£12,565,667	56.77%

3.10 ***Indicator 10***: The Council does not need to set indicators for ***principal sums invested for periods longer than 364 days*** as such investments are not made as the Council is not debt free and is therefore prevented from entering into such transactions at present.

3.11 *Indicator 11: The local authority will estimate for the forthcoming financial year and the following two financial years the ratio of financing costs to net revenue stream.*

3.11.1 The indicator has been calculated as follows using the 2003/04 budget as the basis;

General Fund	HRA	Total
-0.71%	9.66%	7.85%

The indicator has been calculated as net interest costs (debt interest less interest from investments) divided by either HRA income (for the HRA element) and the budget requirement (for the General Fund element).

The split of financing costs as a percentage of net revenue stream can be compared to the split of the total debt outstanding between the HRA and General Fund at the 31 March 2003;

General Fund	HRA	Total
£4,871,275 (22%)	£17,270,884 (78%)	£22,142,159

3.12 *Indicator 12: The local authority will estimate for the forthcoming year the impact of financing costs on the Council Tax.*

3.12.1 This indicator has been calculated using the total budgeted general fund share of PWLB interest divided by the Council Tax Base. The indicator for 2003/04 is £7.99 per Band D property. The indicator for 2004/5 will be calculated when the budget is formalised.

4 Effect on Corporate Priorities

4.1 The Prudential Code will underpin all aspects of local authority capital spending and consequently will have an impact on all corporate priorities.

5 Conclusions and Recommendations

5.1 The code gives greater freedom for borrowing to local authorities but this must be done responsibly. This report indicates the range of indicators Councillors would need to consider, on the advice of the Head of Finance. The code will require the following matters to be taken into account when making capital investment decisions

a) Value for Money - Option appraisal for all projects
b) Stewardship of assets - Asset management planning
c) Service objectives - Strategic planning for the authority
d) Practicality - Achievability of the forward plan
e) Prudence - Implications for external borrowing
f) Affordability - Implications for Council tax

5.2 The indicators contained in this report will assist the Council in ensuring that the above principles are complied with. The Executive should also recognise that the Prudential Code will place a duty on local authorities to ensure that when making any decisions on capital investment explicit regard must be made to:

- Option appraisal
- Asset management planning
- Strategic planning
- Achievability of the forward plan

This will undoubtedly require an enhancement of the current PAR process and the need to plan into the medium term.

5.3 It could be viewed that the indicators as set out above are merely making statutory the safeguards which many authorities already have in place, however the freedom to borrow brings with it responsibilities and the code is designed to make sure that local authorities understand those responsibilities.

5.4 The Executive is RECOMMENDED to note the introduction of the Prudential Regime and to approve the indicators for Taunton Deane Borough Council that have been set out in this report.

Background Papers: Executive 28 May 2003 - The Prudential Code, Executive 10 December 2003, The Prudential Code – An Introduction

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