Appendix 10

Statement of Prudential Indicators

1. Introduction

1.1. The Prudential Code for Capital Finance in Local Authorities (Prudential Code) has been developed by the Chartered Institute of Public Finance and Accountancy to underpin the system of capital finance embodied in Part 1 of the Local Government Act 2003. Local Authorities are no longer subject to government controlled borrowing approvals and are free to determine their own level of capital investment controlled by self-regulation. Central Government does however, for national economic reasons retain a reserve power to set a national limit on the increase in borrowing.

1.2. The key objectives of the Prudential Code are to ensure that capital investment plans are affordable, prudent and sustainable.

1.3. The Prudential Code supports a system of self-regulation that is achieved by the setting and monitoring of a suite of Prudential Indicators that directly relate to each other. The indicators establish parameters within which the County Council should operate to ensure the objectives of the Prudential Code are met.

2. Prudential Indicators

2.1. The Prudential Indicators for which the County Council is required to set limits are as follows:

<u>Gross Debt and the Capital Financing Requirement</u>

2.1.1. This Prudential Indicator provides an overarching requirement that all the indicators operate within and is described in the Prudential Code as follows:

"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 capital financing requirement for the current and next two financial years. If in any of these years there is a reduction in the capital financing requirement, this reduction is ignored in estimating the cumulative increase in the capital financing requirement which is used for comparison with gross external debt. This is a key indicator of prudence. Where the gross debt is greater than the capital financing requirement the reasons for this should be clearly stated in the annual treasury management strategy."

2.1.2. The Interim Chief Financial Officer reports that the County Council had no difficulty meeting this requirement for 2016/17, nor are any difficulties envisaged for the current or future years. This view takes into account all plans and commitments included in the 2018/19 budget policy.

Capital Expenditure

2.1.3. The actual amount of capital expenditure that was incurred during 2016/17, and the estimates of capital expenditure to be incurred for the current and future years that are proposed in the 2018/19 budget policy are as follows:

Capital Expenditure

	2016/17 Actual £m	2017/18 Estimate £m	2018/19 Estimate £m	2019/20 Estimate £m	2020/21 & Beyond Estimate £m
Total Capital Expenditure	**132.1**	**126.6**	**95.7**	**80.3**	**77.7**

Affordability

2.1.4. Financing Costs include the amount of interest payable in respect of borrowing or other long term liabilities and the amount the County Council is required to set aside to repay debt, less interest and investments income.

2.1.5. The actual Net Revenue Stream is the total of revenue support grant, business rate and council tax income.

2.1.6. The prediction of the Net Revenue Stream in this Prudential Indicator for future years assumes changes in the County Council's funding from government and the local taxpayer consistent with expectations in the Medium Term Financial Plan. This is indicative only and in no way meant to influence the actual future years funding or in particular the funding from Council Tax.

2.1.7. The authority shall ensure that the revenue implications of capital finance, including financing costs, are properly taken into account within option appraisal processes, the capital programme and the medium-term forecast. In assessing affordability the authority shall consider the council tax implications of its capital programme, borrowing and investment decisions.

2.1.8. The estimates of the ratio of financing costs to net revenue stream are as follows:

Ratio of Financing Costs to Net Revenue Stream

	2016/17 Actual £m	2017/18 Estimate £m	2018/19 Estimate £m	2019/20 Estimate £m	2020/21 Estimate £m
Financing Costs	**30.9**	**32.5**	**29.4**	**30.2**	**32.2**
Net Revenue Stream	**322.5**	**318.5**	**324.6**	**328.0**	**339.0**
Ratio	**9.58%**	**10.19%**	**9.06%**	**9.21%**	**9.49%**

Capital Financing Requirement

2.1.9. The capital financing requirement is a measure of the extent to which the County Council needs to borrow to support capital expenditure. It does not necessarily relate to the actual amount of borrowing at any one point in time. The County Council has an integrated treasury management strategy where there is no distinction between revenue and capital cash flows and the day-to-day position of external borrowing and investments can change constantly.

2.1.10. The capital financing requirement concerns only those transactions arising from capital spending, whereas the amount of external borrowing is a consequence of all revenue and capital cash transactions combined together following recommended treasury management practice.

2.1.11. The estimates of the end of year capital financing requirement are as follows:

Capital Financing Requirement

	2016/17 Actual £m	2017/18 Estimate £m	2018/19 Estimate £m	2019/20 Estimate £m	2020/21 Estimate £m
Capital Financing Requirement at 31 March	**533.8**	**555.5**	**589.6**	**598.8**	**607.0**

Authorised Limit

2.1.12. The Authorised Limit represents an upper limit of borrowing that could be afforded in the short term but may not be sustainable. This limit includes a risk assessment of exceptional events taking into account the demands of revenue and capital cash flows. The Authorised Limit gauges events that may occur over and above those transactions which have been included in the Operational Boundary.

2.1.13. The Cabinet should note that the Authorised Limit represents the limit specified in section 3 (1) of the Local Government Act 2003 (Duty to determine affordable borrowing limit).

2.1.14. The Chief Financial Officer has delegated authority, within the total Authorised Limit, to effect movement between the separately identified and agreed figures for External Borrowing and Other Long Term Liabilities. Any such changes will be reported to the next Cabinet meeting following the change.

2.1.15. The following Authorised Limits for external debt, excluding temporary investments are recommended:

Authorised Limit for External Debt

	2017/18 £m	2018/19 £m	2019/20 £m	2020/21 £m
External Borrowing	580.0	610.0	620.0	630.0
Other Long Term Liabilities	13.0	13.0	13.0	13.0
Total Authorised limit	**593.0**	**623.0**	**633.0**	**643.0**

Operational Boundary

2.1.16. The Operational Boundary represents an estimate of the most likely, prudent, but not worst case scenario and provides a parameter against which day-to-day treasury management activity can be monitored.

2.1.17. The Interim Chief Financial Officer reports that procedures are in place to monitor the Operational Boundary on a daily basis, and that sufficient authorisation is in place to take whatever action is necessary to ensure that, in line with the Treasury Management Strategy, the cash flows of the County Council are managed prudently.

2.1.18. Occasionally, the Operational Boundary may be exceeded (but still not breach the Authorised Limit) following variations in cash flow. Such an occurrence would follow controlled treasury management action and may not have a significant impact on the prudential indicators when viewed all together.

2.1.19. Consistent with the Authorised Limit, the Chief Financial Officer has delegated authority, within the Total Operational Boundary, to effect movement between the separately identified and agreed figures for External Borrowing and Other Long Term Liabilities. Any such changes will be reported to the next Cabinet meeting following the change.

2.1.20. Both the Authorised Limit and the Operational Boundary include an element relating to debt restructuring where, for the short term only, external borrowing may be made in advance of the repayment of loans. In this circumstance External Borrowing is increased temporarily until the replaced loans are repaid. The converse can also apply where loans are repaid in advance of borrowings.

2.1.21. The following limits for each year's Operational Boundary, excluding temporary investments are recommended:

Operational Boundary for External Debt

	2017/18	2018/19	2019/20	2020/21
	£m	£m	£m	£m
External Borrowing	560.0	590.0	600.0	610.0
Other Long Term Liabilities	10.0	10.0	10.0	10.0
Total Operational Boundary	**570.0**	**600.0**	**610.0**	**620.0**

Actual External Debt

2.1.22. The County Council's actual external debt as at 31/03/17 was £363.2 million, comprising £363.2 million External Borrowing and £0 (zero) Other Long Term Liabilities.

2.1.23. The proportion of the capital financing requirement met by external borrowing will remain at similar levels over the short term until the relationship between short term rates and long term rates changes.

3. PRUDENTIAL INDICATORS FOR TREASURY MANAGEMENT

3.1. The following prudential indicators have been taken into account in the 2018/19 Treasury Management Strategy.

Treasury Management Code of Practice

3.1.1. Worcestershire County Council has adopted the Chartered Institute of Public Finance and Accountancy (CIPFA): Code of Practice for Treasury Management in the Public Services.

Fixed Interest Rate Exposures

3.1.2. It is recommended that the County Council sets an upper limit on its fixed interest rate exposures as follows.

Upper limits for net principal sums outstanding at fixed rates

	2017/18	2018/19	2019/20	2020/21
	£m	£m	£m	£m
Net Principal sums Outstanding at Fixed Rates	**593.0**	**623.0**	**633.0**	**643.0**

3.1.3. This represents the position that all of the County Council's authorised external borrowing may be at a fixed rate at any one time.

Variable Interest Rate Exposures

3.1.4. It is recommended that the County Council sets an upper limit on its variable interest rate exposures as follows.

Upper limits for net principal sums outstanding at variable rates

	2017/18 £m	2018/19 £m	2019/20 £m	2020/21 £m
Net Principal sums Outstanding at Variable Rates	**177.9**	**186.9**	**189.9**	**192.9**

3.1.5. This is the maximum external borrowing judged prudent by the Interim Chief Financial Officer that the council should expose to variable rates.

Maturity Structure of Borrowing

3.1.6. It is recommended that the County Council sets upper and lower limits for the maturity structure of its borrowings as follows:

Amount of projected borrowing that is fixed rate maturing in each period as a percentage of total projected borrowing that is fixed rate.

Period of Maturity	Upper Limit %	Lower Limit %
Under 12 months	**25**	**0**
12 months and within 24 months	**25**	**0**
24 months and within 5 years	**50**	**0**
5 years and within 10 years	**75**	**0**
10 years and above	**100**	**25**

Investments for longer than 364 days

3.1.7. It is recommended that the County Council sets an upper limit of total principal sums invested for periods longer than 364 days of £25 million for 2018/19, 2019/20 and 2020/21.

3.1.8. The Council may hold non-treasury investments for periods longer than 364 days, in assets other than financial instruments. The sums invested in this manner shall not exceed £25m at any one time for 2018/19, 2019/20 and 2020/21.

4. ANNUAL MINIMUM REVENUE PROVISION (MRP) STATEMENT

Introduction

4.1. On the 28 February 2008 the Department for Communities and Local Government issued statutory guidance under the Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2008 that came into force on 31 March 2008.

4.2. The statutory guidance recommends that before the start of each financial year a local authority prepares a statement of its policy on making MRP in respect of that financial year and submits it to full council. The statement should indicate how it is proposed to discharge the duty to make prudent MRP in the financial year.

4.3. The MRP is an amount of revenue money set aside each year for the repayment of external borrowing required to finance capital expenditure.

4.4. MRP should normally commence in the financial year following the one in which the expenditure, to be financed from borrowing, was incurred.

4.5. The regulations include a change to the way MRP is calculated by replacing the detailed formulae for calculating MRP with a duty to make an amount of MRP which the authority considers “prudent”.

Meaning of “Prudent Provision”

4.6. The broad aim of prudent provision is to ensure that debt is repaid over a period that is reasonably commensurate with that over which the capital expenditure provides benefits or, in the case of borrowing supported by Revenue Support Grant, reasonably commensurate with the period implicit in the determination of that grant.

4.7. The guidance specifies four options as methods of making prudent provision as follows:

Option 1: Regulatory Method - where debt is supported by Revenue Support Grant, authorities will be able to continue using the current methodology. As a transitional measure this option is also available for all capital expenditure incurred prior to 1 April 2008.

Option 2: CFR Method - multiplying the Capital Financing Requirement at the end of the preceding year by 4%

Option 3: Asset life Method - amortising expenditure over an estimated useful life for the relevant assets created.

Option 4: Depreciation Method – making charges to revenue based on proper accounting practices for depreciation as they apply to the relevant assets.

4.7.1. Options 1 and 2 may only be used in relation to capital expenditure incurred before 1 April 2008 and capital expenditure incurred on or after that date which forms part of supported capital expenditure.

4.7.2. For unsupported capital expenditure incurred on or after 1 April 2008 Options 3 and 4 apply and can be applied to all capital expenditure, whether or not supported and whenever incurred.

MRP Policy relating to capital expenditure financed from borrowing

4.8. Taking into the need to make prudent provision the Interim Chief Financial Officer recommends that Option 3 is used for all capital expenditure financed by borrowing for the calculation of MRP commencing from 1 April 2017. The calculation is to be made using the annuity method.