

## 2018-2021 Prudential Indicators

### Introduction

- 1.0 The Local Government Act 2003 requires the Authority to adopt the CIPFA Prudential Code and produce prudential indicators. The framework established by the Prudential Code is designed to support local strategic planning, local asset management planning and proper option appraisal. The objectives of the Prudential Code are to ensure, within a clear framework, that the capital expenditure plans of local authorities are affordable, prudent and sustainable, and that treasury management decisions are taken in accordance with good professional practice and in full understanding of the risks involved and how these risks will be managed to levels that are acceptable to the organisation. In exceptional cases the Prudential Code should provide a framework which will demonstrate that there is a danger of not ensuring this, so that the local authority concerned can take timely remedial action.
- 1.1 The Prudential Code requires authorities to look at capital expenditure and investment plans in the light of overall organisational strategy and resources and ensure that decisions are being made with sufficient regard to the long run financing implications and potential risks to the authority. Effective financial planning, option appraisal, risk management and governance processes are essential in achieving a prudential approach to capital expenditure, investment and debt. The Investment Strategy was included as Appendix D (iii) to the 24 January 2018 Cabinet report.
- 1.2 To demonstrate that local authorities have fulfilled these objectives, the Prudential Code sets out the indicators that must be used, and the factors that must be taken into account. The Prudential Code does not include suggested indicative limits or ratios. These will be for the local authority to set itself. Each indicator either summarises the expected capital activity or introduces limits upon that activity, and reflects the outcome of the Authority's underlying investment appraisal systems.
- 1.3 Within this overall prudential framework there is an impact on the Authority's treasury management activity as it will directly impact on borrowing and investment activity. The draft Treasury Management Strategy for 2018/19 was included as Appendix E to the annex of the 24 January 2018 Cabinet report.
- 1.4 The Prudential Code requires the following matters to be taken into account when setting or revising the prudential indicators:
  - a) Service Objectives – e.g. strategic planning for the Authority
  - b) Stewardship of assets – e.g. asset management strategy
  - c) Value for money – e.g. options appraisal
  - d) Prudence and sustainability – e.g. implications of external borrowing
  - e) Affordability – e.g. impact on Housing rents
  - f) Practicality – e.g. achievability of the forward plan

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- 1.5 Matters of affordability and prudence are primary roles for the Prudential Code.
- 1.6 The revenue consequences of capital expenditure relating to the HRA must to be paid for from HRA resources.
- 1.7 Capital expenditure can be paid for through capital receipts, grants etc, but if these resources are insufficient then any residual capital expenditure will add to the HRA's borrowing need.
- 1.8 The key risks to the plans are that the level of funding, such as capital receipt levels or revenue contributions may change as capital receipts are reliant on an active property market.
- 1.9 The indicators cover:
  - Affordability;
  - Prudence;
  - Capital expenditure;
  - External debt; and
  - Treasury management.
- 1.10 Prudential indicators are required to be set as part of the Financial Planning and Budget process. Any revisions must be reported through the financial management process.
- 1.11 The prudential indicators for the forthcoming and future years must be set before the beginning of the forthcoming year. They may be revised at any time, following due processes and must be reviewed, and revised if necessary, for the current year when the prudential indicators are set for the following year.
- 1.12 The following sets down the draft Prudential Indicators as calculated and proposed for North Tyneside Council for 2018–2021. The indicators include those for the Housing Revenue Account.

### **Prudential Indicators for Affordability**

- 1.13 The fundamental objective in considering affordability of the Authority's Investment Plan is to ensure that the total capital investment of the Authority remains within sustainable limits, and in particular to consider the impact on the "bottom line" and hence Council Tax and Housing rents. Affordability is ultimately determined by a judgement on acceptable Council Tax or housing rent levels.
- 1.14 In considering the affordability of its Investment Plan, the Authority is required to consider all the resources that are currently available, and estimated for the future, together with the totality of the Investment Plan, revenue income and revenue expenditure forecasts for the forthcoming year and following two years (as a minimum). The Authority is also required to consider known significant variations beyond this timeframe. This requires the development of rolling

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revenue forecasts as well as capital expenditure plans. In line with the Financial Plan, three-year forecasts have been provided for the prudential indicators.

- 1.15 When considering affordability, risk is an important factor to be considered. Risk analysis and management strategies should be taken into account.
- 1.16 Looking ahead for a three year period, the following are key prudential indicators of affordability:
- the ratio of financing costs to net revenue stream for both the Housing Revenue Account (HRA) and non-HRA services; and
  - the incremental impact on council tax and housing rents. The scope for increases in both these elements is governed by the Government's ability to limit increases.

### Ratio of financing costs to net revenue stream

- 1.17 This indicator identifies the trend in the cost of capital (predominately external interest and MRP) as a proportion of the net revenue budget for the General Fund and housing income for the HRA and is shown in Table 1 below:

**Table 1: Ratio of Financing Costs to Net Revenue Stream**

	2017/18	2018/19	2019/20	2020/21
	Est.	Est.	Est.	Est.
General Fund	7.63%	17.27%	19.67%	20.00%
HRA	30.34%	28.08%	28.70%	31.01%

- 1.18 The above indicator shows costs for all borrowing, both supported and unsupported. It also includes the financing costs of PFI schemes and leases. To enhance the information available for decision-making we have also provided a local indicator to show the proportion of the budget that is spent on unsupported borrowing. This is shown in Table 2 below:

**Table 2: Ratio of Financing Costs for prudential (unsupported) borrowing to Net Revenue Stream**

	2017/18	2018/19	2019/20	2020/21
	Est.	Est.	Est.	Est.
General Fund	6.81%	10.04%	12.33%	12.39%
HRA	7.02%	3.63%	3.89%	6.59%

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- 1.19 The cost of capital related to past and current capital programmes has been estimated in accordance with proper practices. Actual costs will depend on the phasing of capital expenditure and prevailing interest rates, and will be closely managed and monitored on an ongoing basis. Any reprogramming in the Investment Plan, whether planned or unplanned, may delay the impacts of debt financing costs to future years.

### **Prudential Indicators for Prudence**

- 1.20 A key indicator of prudence is that, over the medium term, gross debt will only be used for a capital purpose. Under the Code the underlying need to borrow for a capital purpose is measured by the Capital Financing Requirement (CFR). Gross debt includes external borrowing and also other liabilities including PFI schemes and Finance Leases.

### **Gross debt and Capital Financing Requirement (CFR)**

- 1.21 This key indicator shows that gross debt is not expected to exceed the total CFR including additional capital requirements for 2016/17 to 2019/20.

**Table 5: Gross external debt compared to CFR**

	2017/18	2018/19	2019/20	2020/21
	Est.	Est.	Est.	Est.
	£'000s	£'000s	£'000s	£'000s
External Borrowing	466,715	498,881	508,303	497,469
Other Liabilities (including PFI and Finance Leases)	124,889	123,456	120,123	116,873
Total Gross debt	591,604	622,337	628,426	614,342
Capital Financing requirement	655,379	668,034	656,531	639,470

### **Prudential Indicators for Capital Expenditure**

#### **Estimate of capital expenditure**

- 1.22 This indicator requires reasonable estimates of the total capital expenditure to be incurred during the current financial year and at least the following three financial years.

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1.23 The Investment Plan for 2017-2020 is included in the annex to the report and the figures below are based on that report. A full breakdown of individual projects is shown in Appendix A (i).

**Table 6: Capital Expenditure**

	2017/18	2018/19	2019/20	2020/21
	Est £000's	Est £000's	Est £000's	Est £000's
General Fund	63,007	56,145	19,925	11,803
HRA	24,979	27,914	23,291	20,270
Total	87,986	84,059	43,216	32,073

1.24 There is a risk of cost variations to planned expenditure against the Investment Plan, arising for a variety of reasons, including tenders coming in over/under budget, changes to specifications, slowdown/acceleration of project phasing. There is also the possibility of needing to bring urgent and unplanned capital works into the Investment Plan. These risks are managed by project officers on an ongoing basis, by means of active financial and project monitoring, they will be overseen by the Investment Programme Board and any changes will be made in accordance with Financial Regulations.

1.25 The availability of financing from capital receipts, grants and external contributions also carry significant risks. These risks are particularly relevant to capital receipts, where market conditions are a key driver to the flow of funds, causing problems in depressed or fluctuating market conditions. There is a much reduced reliance on capital receipts in the proposed plan.

### Estimate of Capital Financing Requirement (CFR)

1.26 The CFR can be understood as the Authority's underlying need to borrow money long term for a capital purpose. The CFR is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. The CFR will increase annually by the amount of capital expenditure which is not immediately paid for by grants, contributions, direct revenue funding or capital receipts. The General Fund CFR will also be reduced each year by the amount of Minimum Revenue Provision (MRP) that is set aside in the revenue budget. In addition, the CFR may be reduced by additional voluntary contributions in the form of capital receipts or revenue contributions. The HRA business plan includes provision to reduce the HRA CFR in this way.

1.27 The CFR also includes any other long term liabilities eg PFI schemes and finance leases.

1.28 In accordance with best professional practice the Authority does not associate borrowing with particular items or types of expenditure. The Authority has a number of daily cash flows, both positive and negative, and manages its treasury position in terms of its borrowing and investments in accordance with

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the approved Treasury Management Strategy. In day to day cash management no distinction can be made between revenue cash and capital cash. Over the long term external borrowing may only be incurred for capital purposes.

**Table 7: Capital Financing Requirement**

	2017/18 Est. £000's	2018/19 Est. £000's	2019/20 Est. £000's	2020/21 Est. £000's
General Fund	319,154	335,378	327,770	317,251
HRA	336,225	332,656	328,761	322,219
<b>Total</b>	<b>655,379</b>	<b>668,034</b>	<b>656,531</b>	<b>639,470</b>

1.29 The above indicator shows the total borrowing requirement, both supported and unsupported. To enhance the information available for decision-making we have provided a local indicator to show the Capital Financing Requirement for unsupported borrowing. This is shown in Table 8 below:

**Table 8: Capital Financing Requirement for Unsupported Borrowing**

	2017/18 Est. £000's	2018/19 Est. £000's	2019/20 Est. £000's	2020/21 Est. £000's
General Fund	169,739	208,332	205,350	199,221
HRA	31,746	27,781	25,979	21,687
<b>Total</b>	<b>201,485</b>	<b>236,113</b>	<b>231,329</b>	<b>220,908</b>

### **Prudential Indicators for External Debt**

#### Authorised limit for total external debt

- 1.30 For the purposes of this indicator the authorised limit for external debt is defined as the authorised limit for borrowing plus the authorised limit for other long term liabilities.
- 1.31 This indicator requires the Authority to set, for the forthcoming financial year and following years, an authorised limit for total external debt, separately identifying borrowing from other long term liabilities such as PFI and Finance Leases.
- 1.32 The authorised limit represents the maximum amount the Authority may borrow at any point in time in the year. It has to be set at a level the Authority

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considers is “prudent” and has to be consistent with the plans for capital expenditure and financing.

- 1.33 This limit is based on the estimate of the most likely, but not worse case, scenario with additional headroom to allow for operational management, for example unusual cash movements.
- 1.34 Full Council will be requested to approve these limits and to delegate authority to the Chief Finance Officer, 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.
- 1.35 Any such changes made will be reported to the Cabinet at its next meeting following the change.

**Table 9: Authorised Limit for External Debt**

	2017/18 £000's Est.	2018/19 £000's Est.	2019/20 £000's Est.	2020/21 £000's Est.
Borrowing	1,120,000	1,120,000	1,110,000	1,100,000
Other Long Term Liabilities	160,000	160,000	160,000	160,000
<b>Total</b>	<b>1,280,000</b>	<b>1,280,000</b>	<b>1,270,000</b>	<b>1,260,000</b>

- 1.34 The Chief Finance Officer reports that these Authorised Limits are consistent with the Authority's current commitments, existing plans and the proposals in this 2017/18 budget report for capital expenditure and financing, and in accordance with its approved Treasury Management Policy Statement and Practices.

### Operational Boundary for total external debt

- 1.35 The proposed operational boundary is based on the same estimates as the authorised limit. However, it excludes the additional headroom which allows for unusual cash movements.
- 1.36 The operational boundary represents a key management tool for in year monitoring by the Chief Finance Officer. Within the operational boundary, figures for borrowing and other long term liabilities are identified separately. Full Council will be requested to delegate authority to the Chief Finance Officer, 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.
- 1.37 Any such changes will be reported to the Cabinet at its next meeting following the change.

**Table 10: Operational Boundary for External Debt**

	2017/18 £000's Est.	2018/19 £000's Est.	2019/20 £000's Est.	2020/21 £000's Est.
Borrowing	560,000	560,000	550,000	550,000
Other Long Term Liabilities	140,000	140,000	140,000	140,000
<b>Total</b>	<b>700,000</b>	<b>700,000</b>	<b>690,000</b>	<b>690,000</b>

HRA limit on indebtedness

1.38 Under the reforms of housing finance the Government published *Limits on Indebtedness Determination 2012* which set out the maximum amount of housing debt the Authority could have outstanding at any one time. The limit for North Tyneside was £290.824m. The HRA Capital Financing Requirement excluding the North Tyneside Living PFI scheme should be within the cap set. The table below confirms that the proposals remain within the cap set.

**Table 11: HRA limit on indebtedness**

	2017/18 £000's Est.	2018/19 £000's Est.	2019/20 £000's Est.	2020/21 £000's Est.
Gross HRA capital financing requirement	336,225	332,656	328,761	322,219
Less HRA PFI schemes	76,163	75,009	73,716	72,266
Adjusted HRA capital financing requirement	260,062	257,647	255,045	249,953
HRA limit on indebtedness	290,824	290,824	290,824	290,824

**Prudential Indicators for Treasury Management**Adoption of the CIPFA Code of Practice for Treasury Management

1.39 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. North Tyneside 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 borrowings and investments in accordance with its approved Treasury Management Strategy and Practices.

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### Upper limits on interest rate exposure 2018/19 to 2020/21

- 1.40 Full Council will be requested to set an upper limit on its fixed interest rate exposures for 2018/19, 2019/20 and 2020/21 of 100% of its net outstanding principal sums.
- 1.41 Full Council will be requested to set an upper limit on its variable interest rate exposures for 2018/19, 2019/20 and 2020/21 of 50% of its net outstanding principal sums.
- 1.42 The proposals to set upper and lower limits for the maturity structure of the Authority's borrowings are as follows:

**Table 12: Amount of projected borrowing that is fixed rate maturing in each period as a percentage of total projected borrowing that is fixed rate**

	Upper Limit	Lower Limit
Under 12 months	50%	0%
12 months to 2 years	50%	0%
2 years to 5 years	50%	0%
5 years to 10 years	75%	0%
10 years to 20 years	100%	25%
20 years to 30 years	100%	25%
30 years to 40 years	100%	25%
40 years to 50 years	100%	25%

**Table 13: Upper limit for total principal sums invested for over 365 days**

	2018/19	2019/20	2020/21
<b>% of Investments with Maturity over 364 days</b>	25%	25%	25%

- 1.43 The above indicator sets the exposure of investments in excess of 365 days at no more than 25% of the portfolio.