CABINET
5TH DECEMBER 2006

ITEM NO. ....

PRUDENTIAL INDICATORS UPDATE AND TREASURY MANAGEMENT HALF-YEAR REVIEW

Responsible Cabinet Member – Councillor Don Bristow, Resource Management Portfolio

Responsible Director – Paul Wildsmith, Director of Corporate Services

Purpose of Report

1. This report provides an update of the Prudential Indicators and a half yearly review of the Council's Treasury Management borrowing and investment activities.

Introduction

2. From 1st April 2004 Local Authorities were given extra freedoms with regard to borrowing. As part of these new freedoms councils can borrow without recourse to central government, with the proviso that the additional borrowing is both prudent and affordable.

3. A framework was developed by CIPFA, "The Prudential Code for Capital Finance", which is mandatory under the Local Government Act 2003. As part of this framework all authorities must report to Council at the beginning of each year certain statistics, the Prudential Indicators, these relate to capital expenditure and borrowing and what effect that borrowing will have on council tax levels and housing rent levels, other statistics relating to treasury management are also be included.

4. Council must approve three statutory reports relating to the Prudential Code every year, one before the start of the year, one at the end of the financial year and this one mid year. Because our capital programme changes throughout the year then the statistics behind the capital programme also change and it is essential that Council approves those changes. The following tables show the new statistics that are expected by the end of the year, against those approved at the beginning of the year.

Information and Analysis

Capital Expenditure and Borrowing Indicators

5. **Table 1** shows the first Prudential Indicator which is actual and expected levels of Capital Expenditure for 2005/06 and 2006/07 to 2008/09. The changes to the 2006/07 capital expenditure estimates have been notified to Cabinet as part of the Capital Budget Monitoring process.

Table 1

Capital Expenditure	2005/06 Actual	2006/07 Original Estimate	2006/07 Revised Estimate	2006/07 Variance	2007/08 Original Estimate	2007/08 Revised Estimate	2007/08 Variance	2008/09 Original Estimate	2008/09 Revised Estimate	2008/09 Variance
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
Total non-HRA-	27.022	14.404	34.947	20.543	19.075	30.703	11.628	10.583	11.299	0.716
Total HRA -	10.254	10.922	14.779	3.857	10.544	10.544	0.0	8.838	8.838	0.0
Total	37.276	25.326	49.726	24.400	29.619	41.247	11.628	19.421	20.137	0.716

6. The main changes are detailed below:-

   (a) The original Prudential Indicators assumed that all the capital funding secured for 2006/07 would be expended that year. However, resources of c£22m have been carried forward from 2005/06, whilst some of this was slippage the majority of this wasn't expected to be spent until a later date. This, together with other additional approvals already approved by Members as part of the capital budget monitoring process, has increased the anticipated Capital Expenditure for 2006/07.

   (b) Although the total capital resources available to the Authority is £64.396m, as per Cabinet report on 7th November, it is again unlikely that this full amount will be incurred in 2006/07. Therefore, where the profile of spend is expected to cover more than 2006/07, future years Capital expenditure has been amended to reflect this profile.

   (c) A full reconciliation of the changes in Capital Expenditure by Service is attached at **Appendix 1.**

Changes to the financing of the capital programme and estimates and actuals for the capital financing requirement and the external debt

7. **Table 2** below draws together the main strategy elements of the capital plans, highlighting the supported and unsupported elements of the capital programme, and the expected financing arrangements for this capital expenditure. The second half of the table shows the Capital Financing Requirement (CFR), which is the Council's underlying external indebtedness for capital purposes, compared to the expected borrowing and financing position. The actual 2005/06 position is shown for comparative purposes. The Council's CFR flows directly from the capital expenditure plans and is also adjusted for annual revenue charge for debt repayment.

Table 2

	2005/06 Actual	2006/07 Original Estimate	2006/07 Revised Estimate	2006/07 Variance	2007/08 Original Estimate	2007/08 Revised Estimate	2007/08 Variance	2008/09 Original Estimate	2008/09 Revised Estimate	2008/09 Variance
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
Capital Expenditure										
Supported Spend	33.039	19.716	34.792	15.076	26.319	37.869	11.550	16.626	17.342	0.716
Unsupported Spend	4.137	5.610	14.934	9.324	3.300	6.408	3.108	2.795	2.795	0.0
Total spend	37.276	25.326	49.726	24.400	29.619	44.247	14.628	19.421	20.137	0.716
Financed By										
Capital receipts	5.212	2.867	4.365	1.498	4.453	4.829	0.376	2.460	2.725	0.265
Capital grants	16.697	10.394	21.629	11.235	16.741	27.876	11.135	9.334	9.836	0.502
Capital Reserves	0.0	0.000	0.0	0.0	0.000	0.0	0.0	0.000	0.0	0.0
Capital Contribution	1.156	0.112	1.806	1.694	0.100	0.100	0.0	0.100	0.100	0.0
Revenue	3.100	2.100	3.523	1.423	1.800	1.860	0.060	1.500	1.500	0.0
Net Financing Need for the year- Borrowing	11.111	9.853	18.403	8.550	6.525	9.582	3.057	6.027	5.976	-0.051
Prudential Indicator - Capital Financing Requirement										
CFR – Non Housing	53.451	68.012	65.827	-2.185	68.038	69.531	1.493	67.957	70.564	2.607
CFR - Housing	26.401	31.746	29.895	-1.851	34.786	32.950	-1.836	37.164	35.340	-1.824
Total CFR	79.852	99.758	95.722	-4.036	102.824	102.482	-0.343	105.121	105.904	0.784
Net movement in CFR	8.731	6.527	16.129	9.602	3.066	8.760	5.694	2.297	3.422	1.125
Prudential Indicator – External Debt										
Borrowing	86.603	99.758	95.722	-4.036	102.824	102.482	-0.342	105.121	105.924	0.783
Other long term liabilities	0.244	0.209	0.209	0.0	0.172	0.172	0.0	0.132	0.132	0.0
Total Debt 31 March	86.847	99.967	95.931	-4.036	102.996	102.654	-0.342	105.253	106.036	0.783

Limits to Borrowing Activity

8. **Table 3** shows the relationship of net borrowing to the Capital Financing Requirement. The first key control over the Council's activity is a Prudential Indicator to ensure that over the medium term, net borrowing will only be for a capital purposes. Net external borrowing should 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 2006/07 and next two financial years. This allows some flexibility for limited early borrowing for future years.

Table 3

	2005/06 Actual	2006/07 Original Estimate	2006/07 Revised Estimate	2006/07 Variance	2007/08 Original Estimate	2007/08 Revised Estimate	2007/08 Variance	2008/09 Original Estimate	2008/09 Revised Estimate	2008/09 Variance
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
Gross Borrowing	86.847	99.758	95.722	-4.036	102.824	102.482	-0.342	105.121	105.904	0.783
Investments	46.023	37.369	45.971	8.602	35.856	45.080	9.224	33.165	38.399	5.234
Net Borrowing	40.824	62.389	49.751	-12.638	66.968	57.402	-9.566	71.956	67.505	-4.451
CFR	79.852	99.758	95.722	-4.036	102.824	102.482	-0.342	105.121	105.904	0.783

9. The Director of Corporate Services reports that the Council complied with the requirement to keep net borrowing below the relevant CFR in 2005/06, and no difficulties are envisaged for the current or future years. This view takes into account current commitments, existing plans, and the proposals in this report.

10. A further two Prudential Indicators control the overall level of borrowing. **Table 4.** These are :-

    (a) **The authorised limit** – This represents the limit beyond which borrowing is prohibited, and needs to be set and revised by Members. It reflects the level of borrowing which, while not desired, could be afforded in the short term, but is not sustainable. It is the expected maximum borrowing need with some headroom for unexpected movements. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003 (for England and Wales). The amendments that are proposed to this Prudential Indicator reflect the profile of spend now predicted for 2006/07 and 2007/08 the limit for 2008/09 brings the position back to almost its original estimate.

    (b) **The operational boundary** –This indicator is based on the probable external debt during the course of the year; it is not a limit and actual borrowing could exceed this boundary for short times during the year. CIPFA expect that this should act as an indicator to ensure the authorised limit is not breached. Again this limit has been amended to reflect changes in the profile of spend.

Table 4

Authorised limit for external debt	2005/06 Actual	2006/07 Original Estimate	2006/07 Revised Estimate	2006/07 Variance	2007/08 Original Estimate	2007/08 Revised Estimate	2007/08 Variance	2008/09 Original Estimate	2008/09 Revised Estimate	2008/09 Variance
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
Authorised Limit	86.847	118.172	112.380	-5.792	121.697	119.992	-1.705	124.339	123.928	-0.411
Operational Boundary	86.847	102.758	97.722	-5.036	105.824	104.341	-1.483	108.121	107.764	-0.357

Affordability Prudential Indicators

11. **Actual and estimates of the ratio of financing costs to net revenue stream – Table 5** This indicator identifies the trend in the cost of capital (borrowing costs net of interest and investment income) as a percentage of net revenue budget. The variations are due to alterations to the Authority's Treasury Management Budget as detailed at paragraph 28-30.

Table 5

	2005/06 Actual	2006/07 Original Estimate	2006/07 Revised Estimate	2006/07 Variance	2007/08 Original Estimate	2007/08 Revised Estimate	2007/08 Variance	2008/09 Original Estimate	2008/09 Revised Estimate	2008/09 Variance
Non-HRA	1.19%	2.99%	2.29%	0.7%	3.14%	3.14%	0%	3.27%	3.27%	0%
HRA	9.25%	10.82%	10.82%	0.0	12.60%	12.60%	0%	14.16%	14.16%	0%

12. **Estimates of the incremental impact of capital investment decisions on the council tax –Table 6**. This indicator identifies the trend in the cost of changes in the three-year capital programme compared to the Council's original budget commitments. As the amount of Corporate unsupported prudential borrowing to be undertaken has not changed there is no change to the incremental effect on Council Tax. Although some departmental unsupported borrowing is anticipated to be undertaken, in the form of invest to save schemes and replacing leased assets i.e. computer equipment with assets paid for by prudential borrowing, the repayment of this borrowing will be able to be accommodated within Departmental resource allocations, which will therefore have no incremental effect on Council Tax.

Table 6

	2005/06 Actual	2006/07 Original Estimate	2006/07 Revised Estimate	2006/07 Variance	2007/08 Original Estimate	2007/08 Revised Estimate	2007/08 Variance	2008/09 Original Estimate	2008/09 Revised Estimate	2008/09 Variance
Council Tax – Band D	£1.76	£2.15	£2.15	£0.0	£5.04	£5.04	£0.0	£7.81	£7.81	£0.0

13. **Actual and estimates of the incremental impact of capital investment decisions on housing rent levels – Table 7**. Similar to the Council tax calculation this indicator identifies the trend in the cost of changes in the housing capital programme compared to the Council's original commitments, expressed as a change in weekly rent levels. Within the Housing's Capital Programme unsupported borrowing is to be undertaken to ensure that the Authority meets the Decent Home Standard. However the additional repayment costs are to be accommodated within Housing Revenue Account resources, the increased financing charges will be compensated by a reduction in other management costs therefore there is to be no incremental effect on housing rent levels.

Table 7

	2005/06 Actual	2006/07 Original Estimate	2006/07 Revised Estimate	2006/07 Variance	2007/08 Original Estimate	2007/08 Revised Estimate	2007/08 Variance	2008/09 Original Estimate	2008/09 Revised Estimate	2008/09 Variance
Weekly Housing Rents	Nil	Nil	Ni	Nil	Nil	Nil	Nil	Nil	Nil	Nil

Treasury Management Prudential Indicators

14. The first Treasury Management indicator is a simple yes or no regarding the adoption of the CIPFA Code of practice on Treasury Management. This Council adopted the Code of Practice on Treasury Management on 21st March 2002 (Min Ref 63/Mar/2002 refers) and so the Council consistently and continually complies with the indicator.

15. There are four further indicators:-

Upper Limits On Variable Rate Exposure – **Table 8.** This indicates a maximum limit for variable interest rates based upon the debt position net of investments.

Upper Limits On Fixed Rate Exposure – Similar to the previous indicator this covers a maximum limit on fixed interest rates.

Historically for a number of years this council has used these percentages; together they give flexibility to the treasury management strategy allowing the Council to take advantage of both fixed and variable rates in their portfolio whilst ensuring that its exposure to variable rates of interest is limited.

Table 8

	2005/06 Actual	2006/07 Original Estimate	2006/07 Revised Estimate	2006/07 Variance	2007/08 Original Estimate	2007/08 Revised Estimate	2007/08 Variance	2008/09 Original Estimate	2008/09 Revised Estimate	2008/09 Variance
Prudential indicator limits based on debt net of investments										
Limits on fixed interest rates	100%	100%	100%	0%	100%	100%	0%	100%	100%	0%
Limits on variable interest rates	0%	40%	40%	0%	40%	40%	0%	40%	40%	0%

16. **Maturity Structures of Borrowing** – **Table 9.** These gross limits are set to reduce the Council's exposure to large values fixed rate loans (those instruments which carry a fixed interest rate for the duration of the instrument) falling due for refinancing within short periods. The higher limits for longer periods reflect the current yield curve for debt i.e. that longer maturity periods attract lower interest rates.

Table 9

	2005/06 Actual	2006/07 Original Estimate	2006/07 Revised Estimate	2006/07 Variance	2007/08 Original Estimate	2007/08 Revised Estimate	2007/08 Variance	2008/09 Original Estimate	2008/09 Revised Estimate	2008/09 Variance
Maturity Structure of fixed borrowing upper limits										
Under 12 months	0%	25%	25%	0%	25%	25%	0%	25%	25%	0%
12 months to 2 years	0%	40%	40%	0%	40%	40%	0%	40%	40%	0%
2 years to 5 years	0%	60%	60%	0%	60%	60%	0%	60%	60%	0%
5 years to 10 years	6%	80%	80%	0%	80%	80%	0%	80%	80%	0%
10 years and above	94%	100%	100%	0%	100%	100%	0%	100%	100%	0%

17. **Total Principal Funds Invested – Table 10**. These limits are based on the Authority's projected reserves and are the level of core investments available to the Authority. This limit allows the authority to invest for longer periods should they be more advantageous in their rate of return that shorter period. It also allows some stability in the interest returned to the authority.

Table 10

	2005/06 Actual	2006/07 Original Estimate	2006/07 Revised Estimate	2006/07 Variance	2007/08 Original Estimate	2007/08 Revised Estimate	2007/08 Variance	2008/09 Original Estimate	2008/09 Revised Estimate	2008/09 Variance
Maximum principal sums invested > 364 days	£6.75m	£10m	£10m	£0m	£10m	£10m	£0m	£10m	£10m	£0m

Half Yearly Treasury Management Review

18. The next part of the report provides a half yearly review of the Council's Treasury Management borrowing and investment activities. The Council defines its Treasury Management activities as: -

    'The management of the organisation's cashflow, it's banking, money market and capital market transactions; the effective management of risks associated with those activities; and the pursuit of optimum performance consistent with those risks.'

19. Investment decisions must always balance the twin objectives of maximising the rate of return and minimising risk. Hence the Council has a prudent policy of limiting the exposure of the Authority's funds to certain financial institutions and maintaining a maximum limit of investment with any such institution.

Treasury Management Activity from 1st April 2006 to 30th September 2006

Short Term Investments

20. Cash balances are invested on a daily basis to maximise the benefit of temporary surplus funds. A total of 137 investments were made in the period 1st April 2006 to 30th September 2006 totalling £115.825m. These were for periods of between 1 and 364 days and earned interest of £0.597m at an average daily rate of 4.65%.

Long Term Investments

21. The Council's reserves and capital receipts are invested for varying periods up to the maximum permitted time of 4 years. The level of these investments has remained the same during the year at £24.900m. Some individual loans within the £24.900m have matured and been renewed during this period. The long-term investments have earned interest of £0.604m for the first six months of 2006/07 at an average rate of 4.81%.

Investment returns measured against the Finance Service Plan

22. The target for our investments returns is to better or at least match a number of external comparators.

23. As can be seen from **Table 11** below, both the short term and long term investments achievements are above market expectations. The long term investments are exceeding the long term indicators due to placing investments for longer periods of time. The short-term investments are higher than the average of short-term indicators again due to undertaking longer-term investments at periods when rates were higher and also taking advantage of competitive short-term rates. However because interest rates are rising and some investments have still to mature and are at lower rates than currently can be achieved the target as set in the Finance Service Plan may not be achieved at the end of 2006/07.

Table 11

	Short Term Investments %	**Long Term Investments %**
Darlington Borough Council -Actual	**4.65**	**4.81**
External Comparators		
Local Authority- 2 day	4.57	
Local Authority - 7 day	4.57	
Local Authority - 6 months		4.76
Local Authority - 12 months		4.93
London Inter Bank Bid Rate – 7 day	4.60	4.60
Average of External Comparators	**4.58**	**4.76**

Borrowing

24. To date during 2006-07 2 new loans of £5.000m have been taken with the Public Works Loan Board (PWLB) for a period of 42 years at an average interest rate of 4.125%. This is in line with the Prudential Indicators and the Treasury Management Budget. Further loans maybe taken later in the year.

25. Throughout the year to date 9 loans have been rescheduled amounting to £18.239m, these loans have been replaced with loans at a reduced annual interest rate, saving the general fund annual interest of £0.036m per annum.

26. Two market loans (not through the Public Works Loans Board) taken out in 2002 were stepped loans, this means that for the first 3 to 4 years interest payable was at a lower than market rate. After this initial period the loans reverted to a higher rate more in line with market rates i.e. 5.32% and 4.99% respectively as opposed to 3.99% and 3.25%. This meant that our consolidated rate of interest would rise when these new rates are applied to our debt in 2006/07. However, included in the loans that we have rescheduled during 2006/07 are the 2 market loans they now have a fixed interest rates of 5.15% and 4.85% respectively for the next five years.

27. The impact of these 2 market loans in our debt portfolio meant that at the beginning of this financial year our consolidated rate of interest rose from 4.69% at the end of 2005/06 to 4.78% at the beginning of 2006/07, this has since been reduced at the present time to 4.725%.

Treasury Management Budget

28. There are three main elements within the Treasury Management Budget:-

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    29. Medium term investments interest earned – a cash amount of £24m, which earns interest and represents the Council's revenue and capital balances, unused capital receipts, reserves and provisions.

    30. Cashflow interest earned – since becoming a unitary council in 1997, the authority has consistently had a positive cashflow. Unlike medium term investments it does not represent any particular sum but it is the result of the council doing business. This is difficult to forecast, as it is the consequence of many different influences such as receipt of grants, the relationship of debtors to creditors, cashing of cheques and payments to suppliers.

    31. Debt servicing costs – This is the principal and interest on the Council's long-term debt to finance the capital programme.

32. The Treasury Management budget has recently been reviewed and the following changes to the 2006/07 budget should now be made. These changes are as the result of proactive management decisions and a more optimistic view on the quantum of cashflow and interest rate outlook.

Changes to Treasury Management Budget 2006/07
Table 12

	£m	£m
Original Treasury Management Medium Term Financial Plan		**3.588**
<u>Changes in Debt Repayments (Principal and Interest)</u>		
Changes in the profile and size of the Capital Programme		-0.191
<u>Changes to the provision for future interest payments</u>		
Provision for smoothing out repayments for money market debt no longer required		–0.151
<u>Changes to investment interest levels</u>		
Increased interest rate on Capital investments	-0.185	
Increased volume and higher rate of return for temporary cashflow investments	-0.403	
Payments to internal funds due to increased rates of Interest	0.087	-0.501
Revised Treasury Management Medium Term Financial Plan		**2.745**

33. This statement concludes that the Treasury Management budget is forecast to underspend by £0.843m 2006/07, with the surplus being returned to Council balances.

Conclusion

34. The prudential indicators have been updated to take account of the Council's borrowing position. However, the maximum borrowing levels (the Authorised Limit and the Operational Boundary), the key indicators have been reduced to reflect the new profile of the Capital Programme. The Council's return on investments has been good, exceeding the target set of matching external comparators for the first six months of the current financial year. Based on the first six months of 2006/07 the Council's borrowing and investments is forecast to produce a saving of £0.843m on the 2006/07 approved budget.

Outcome of Consultation

35. No formal consultation was undertaken in the production of this report.

Legal Implications

36. This report has been considered by the Borough Solicitor for legal implications in accordance with the Council's approved procedures. There are no issues which the Borough Solicitor considers need to be brought to the specific attention of Members, other than those highlighted in the report.

Section 17 of the Crime and Disorder Act 1998

37. The contents of this report have been considered in the context of the requirements placed on the Council by Section 17 of the Crime and Disorder Act 1998, namely, the duty on the Council to exercise its functions with due regard to the likely effect of the exercise of those functions on, and the need to do all that it reasonably can to prevent, crime and disorder in its area. It is not considered that the contents of this report have any such effect.

Council Policy Framework

38. The prudential Indicators are a matter that are required to be considered by Council

Decision Deadline

39. For the purposes of the 'call in' procedure this does not represent an urgent matter.

Key Decisions

40. This report does not represent a key decision.

Recommendation

41. It is recommended that: -

    (a) The revised prudential indicators and limits within the report in Tables 1 to 10 are approved.
    (b) The Treasury Management half yearly review is noted.
    (c) That this report is forwarded to Council, in order for the updated prudential indicators to be approved.

Reasons

42. The recommendations are supported by the following reasons: -

    (a) In order to comply with the Prudential Code for Capital Finance in Local Authorities.
    (b) To inform Members of the performance of the Treasury Management function.
    (c) To comply with the requirements of the Local Government Act 2003

Paul Wildsmith
Director of Corporate Services

Background Papers

Capital Medium Term Financial Plan 2006/07-2008/09
Accounting Records
The Prudential Code for Capital Finance in Local Authorities

Elaine Hufford: Extension 2447
TAB