CABINET
29 NOVEMBER 2005

ITEM NO. ....

PRUDENTIAL INDICATORS UPDATE AND TREASURY MANAGEMENT HALF-YEAR REVIEW

Responsible Cabinet Member(s) – Councillor Don Bristow, Resource Management Portfolio
Responsible Director(s) – Paul Wildsmith, Director of Corporate Services

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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. Prior to that date Local Authorities could only borrow with the approval of Central Government through the credit approvals procedures. 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 "The Prudential Code for Capital Finance" as part of this framework all authorities must report to Council at the beginning of each year certain statistics, the Prudential Indicators, that 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 also have to be included.

4. Council must approve three statutory reports relating to the Prudential Code every yea,r one before the start of the year, one at the end of the financial year and this one mid year. Because our capital programme moves throughout the year then the statistics behind the capital programme also move and is essential that Council approves those movements. 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

Recent changes to Capital Expenditure by Service

5. **Table 1** shows the first Prudential Indicator, which highlights the actual 2004/05 position and changes between the original capital programme and the current position for 2005/06 to 2007/08. The changes to the 2005/06 capital expenditure estimates have been notified to Cabinet as part of the Capital Budget Monitoring process.

Table 1

Capital Expenditure	2004/05 Actual	2005/06 Original Estimate	2005/06 Revised Estimate	2005/06 Variance	2006/07 Original Estimate	2006/07 Revised Estimate	2007/08 Variance	2007/08 Original Estimate	2007/08 Revised Estimate	2007/08 Variance
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
Total non-HRA-	23.258	18.674	44.187	25.513	12.217	15.889	3.672	8.305	21.270	12.965
Total HRA -	6.606	9.987	11.182	1.195	8.280	8.296	0.016	8.213	8.229	0.016
Total	29.864	28.661	55.369	26.708	20.497	24.185	3.688	16.518	29.499	12.981

6. The main changes are detailed below:-

   (a) The original Prudential Indicators assumed that all the capital funding secured for 2005/06 would be expended that year. However, resources of c£16m have been carried forward from 2004/05 due to slippage. This, together with other approvals already notified to Members as part of the capital budget monitoring process, has increased the anticipated Capital Expenditure for 2005/06.

   (b) Although the total capital resources available to the Authority is £56.099m, it is again unlikely that this full amount will be incurred in 2005/06 and a similar position to previous years is anticipated to occur, whereby a significant amount of slippage will be carried forward to future years, thus smoothing the annual profile of the Capital spend.

   (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 original 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, which is the Council's underlying external indebtedness for a capital purpose, compared to the expected borrowing and financing position. The actual 2004/05 position is shown for comparative purposes.

Table 2

	2004/05 Actual	2005/06 Original Estimate	2005/06 Revised Estimate	2005/06 Variance	2006/07 Original Estimate	2006/07 Revised Estimate	2006/07 Variance	2007/08 Original Estimate	2007/08 Revised Estimate	2007/08 Variance
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
Capital Expenditure										
Supported Spend	24.817	19.761	38.880	19.119	13.097	18.385	5.288	11.787	23.699	11.912
Unsupported Spend	5.047	8.900	16.489	7.589	7.400	5.800	-1.600	4.731	5.800	1.069
Total spend	29.864	28.661	55.369	26.708	20.497	24.185	3.688	16.518	29.499	12.981
Borrowing	11.897	15.033	24.549	9.516	10.647	11.887	1.240	8.125	14.820	6.695
Capital receipts	3.824	4.307	4.771	0.464	1.657	5.109	3.452	1.500	7.408	5.908
Capital grants	13.762	9.221	21.699	12.478	8.093	7.077	-1.016	6.793	7.171	0.378
Capital Reserves	0.00	0.000	0.140	0.140	0.000	0.000	0.000	0.000	0.000	0.000
Capital Contribution	0.369	0.100	1.338	1.238	0.100	0.112	0.012	0.100	0.100	0.000
Revenue	0.012	0.000	2.872	2.872	0.000	0.000	0.000	0.000	0.000	0.000
Prudential Indicator - Capital Financing Requirement										
CFR – Non Housing	45.453	59.042	64.638	5.596	63.886	70.498	6.612	66.144	79.188	13.044
CFR - Housing	25.188	29.801	28.593	-1.208	32.891	31.683	-1208	35.786	34.578	-1.208
Total CFR	70.641	88.843	93.231	4.388	96.777	102.181	5.404	101.930	113.766	11.836
Net movement in CFR	10.842	18.202	22.590	4.388	7.934	13.338	5.404	5.153	16.989	11.836
Borrowing	72.228	91.273	92.988	1.715	99.207	101.972	2.765	104.360	113.594	9.234
Other long term liabilities	0.286	0.000	0.243	0.243	0.000	0.209	0.209	0.000	0.172	0.172
Total Debt 31 March	72.514	91.273	93.231	1.958	99.207	102.181	2.974	104.360	113.766	9.406

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 purpose. 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 2005/06 and next two financial years. This allows some flexibility for limited early borrowing for future years.

Table 3

	2004/05 Actual	2005/06 Original Estimate	2005/06 Revised Estimate	2005/06 Variance	2006/07 Original Estimate	2006/07 Revised Estimate	2006/07 Variance	2007/08 Original Estimate	2007/08 Revised Estimate	2007/08 Variance
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
Gross Borrowing	72.514	91.273	93.231	1.958	99.207	102.181	2.974	104.360	113.766	9.406
Investments	35.300	28.900	37.475	-8.575	30.430	33.285	-2.855	27.600	31.471	-3.871
Net Borrowing	37.214	62.373	55.756	-6.617	68.777	68.896	0.119	76.760	82.295	5.535
CFR	70.641	88.843	93.231	4.388	96.777	102.181	5.404	101.930	113.766	11.836

9. The Director of Corporate Services reports that the Council complied with the requirement to keep net borrowing below the relevant CFR in 2004/05, 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). No amendments are proposed to this Prudential Indicator.

    (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 vary around this boundary for short times during the year. CIPFA anticipate that this should act as an indicator to ensure the authorised limit is not breached.

Table 4

Authorised limit for external debt	2004/05 Actual	2005/06 Original Estimate	2005/06 Revised Estimate	2005/06 Variance	2006/07 Original Estimate	2006/07 Revised Estimate	2006/07 Variance	2007/08 Original Estimate	2007/08 Revised Estimate	2007/08 Variance
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
Authorised Limit	97.035	108.414	108.414	0.000	117.538	117.538	0.000	123.464	123.464	0.000
Operational Boundary	84.379	94.273	94.273	0.000	102.207	102.207	0.000	107.360	107.360	0.000

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) against the net revenue stream. The variations are due to alterations to the Authority's Treasury Management Budget as detailed at paragraph 27.

Table 5

	2004/05 Actual	2005/06 Original Estimate	2005/06 Revised Estimate	2005/06 Variance	2006/07 Original Estimate	2006/07 Revised Estimate	2006/07 Variance	2007/08 Original Estimate	2007/08 Revised Estimate	2007/08 Variance
Non-HRA	1.36%	2.65%	2.30%	-0.35%	3.32%	3.32%	0.00%	3.62%	3.62%	0.00%
HRA	14.30%	11.22%	10.71%	-0.51%	14.70%	14.70%	0.00%	18.57%	18.57%	0.00%

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, 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

	2004/05 Actual	2005/06 Original Estimate	2005/06 Revised Estimate	2005/06 Variance	2006/07 Original Estimate	2006/07 Revised Estimate	2006/07 Variance	2007/08 Original Estimate	2007/08 Revised Estimate	2007/08 Variance
Council Tax - Band D	£2.58	£4.95	£4.95	£0.00	£20.28	£20.28	£0.00	£25.90	£25.90	£0.00

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, therefore there is to be no incremental effect on housing rent levels.

Table 7

	2004/05 Actual	2005/06 Original Estimate	2005/06 Revised Estimate	2005/06 Variance	2006/07 Original Estimate	2006/07 Revised Estimate	2006/07 Variance	2007/08 Original Estimate	2007/08 Revised Estimate	2007/08 Variance
Weekly Housing Rents	Nil	Nil	Nil	Nil	Nil	Nil	Nil	Nil	Nil	Nil

Treasury Management Prudential Indicators

14. The first Treasury Management indicator requires 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).

15. There are four further indicators:

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

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

Table 8

	2004/05 Actual	2005/06 Original Estimate	2005/06 Revised Estimate	2005/06 Variance	2006/07 Original Estimate	2006/07 Revised Estimate	2006/07 Variance	2007/08 Original Estimate	2007/08 Revised Estimate	2007/08 Variance
Prudential indicator limits based on debt net of investments										
Limits on fixed interest rates	98.2%	100%	100%	0%	100%	100%	0%	100%	100%	0%
Limits on variable interest rates	1.8%	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 fixed rate loans (those instruments which carry a fixed interest rate for the duration of the instrument) falling due for refinancing.

Table 9

	2004/05 Actual	2005/06 Original Estimate	2005/06 Revised Estimate	2005/06 Variance	2006/07 Original Estimate	2006/07 Revised Estimate	2006/07 Variance	2007/08 Original Estimate	2007/08 Revised Estimate	2007/08 Variance
Maturity Structure of fixed borrowing										
Under 12 months	0.3%	25%	25%	0%	25%	25%	0%	25%	25%	0%
12 months to 2 years	1.5%	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	8.0%	80%	80%	0%	80%	80%	0%	80%	80%	0%
10 years and above	90.2%	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. It is proposed that the limit for funds invested inexcess of 364 days is increased from £7.5m to £10m to allow the Authority additional flexibility when securing advantageous interest rates when placing investments.

Table 10

	2004/05 Actual	2005/06 Original Estimate	2005/06 Revised Estimate	2005/06 Variance	2006/07 Original Estimate	2006/07 Revised Estimate	2006/07 Variance	2007/08 Original Estimate	2007/08 Revised Estimate	2007/08 Variance
Maximum principal sums invested > 364 days	£6.75m	£7.5m	£10.0m	£2.5m	£7.5m	£10.0m	£2.5m	£7.5m	£10.0m	£2.5m

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 2005 to 30th September 2005

Short Term Investments

20. Cash balances are invested on a daily basis to maximise the benefit of temporary surplus funds. A total of 157 investments were made in the period 1st April 2005 to 30th September 2005 totalling £104.89m. These were for varying periods and earned interest of £0.416m at an average daily rate of 4.76%.

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. These investments have increased from £19.900m to £24.900m due to projected variances in the Authority's reserves position. Some individual loans within the £24.900m have matured and been renewed during this period. The long-term investments have earned interest of £0.617m for the first six months of 2005/06 at an average rate of 4.95%.

Investment returns measured against the Finance Service Plan

22. It is not possible to set a numerical interest rate target in advance due to the vagaries in the money markets. However, it is possible to look back at key market indicators, always having regard to an optimum balance between risk and return, to get a measure of investment performance. A representative set of indicators has been used in the table below to measure investment performance.

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, when rates where higher than currently being experienced. As these investments come to an end, they will be replaced with investments at the current rate, which will reduce, the actual return achieved closer to the average of long-term indicators by the end of the financial year. 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. It is expected by the end of the financial year that both the returns on the short term and long term investments will remain above the average of all indicators. If this occurs then the target as set in the Finance Service Plan will be achieved.

Table 11

	Short Term Investments %	Long Term Investments %
Actual	**4.76**	**4.95**
Local Authority- 2 day	4.60	
Local Authority - 7 day	4.60	
Local Authority - 6 months		4.62
Local Authority - 12 months		4.62
London Inter Bank Bid Rate – 7 day	4.61	4.61
Average of all Indicators	**4.60**	**4.62**

Borrowing

24. To date during 2005-06 new loans of £10.500m has been taken with the Public Works Loan Board (PWLB) for a period of 29 years at an average interest rate of 4.40%. This is in line with the Prudential Indicators and the Treasury Management Budget. Further loans maybe taken later in the year. No rescheduling has taken place and no outstanding loans have been repaid.

Treasury Management Budget

25. There are three main elements within the Treasury Management Budget

    (a) Medium term investments interest earned – a cash amount of between £19m and £24m, which earns interest and represents the Council's revenue and capital balances, unused capital receipts, reserves and provisions.

    (b) 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.

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

26. The Treasury Management budget has recently been reviewed and the following changes to the 2005/06 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 2005/06

Table 12

	£m	£m
Treasury Management Medium Term Financial Plan		**2.947**
Changes in Debt Repayments (Principal and Interest)		
Utilisation of Capital Receipts 2004/05 (Due to flexibility allowed by Prudential Borrowing)	-0.060	
Changes in the profile and size of the Capital Programme	-0.071	
Total changes in Debt repayments (Principal and Interest)		-0.131
Changes in Investment Levels / Interest		
Increased Cashflow	-0.115	
Higher returns on Investments	-0.006	
Increased / (Decreased) levels of Medium Term Investments	-0.133	
Total Changes in Investment Interest / Levels		-0.254
Total Financing Costs Savings		-0.385
Revised Treasury Management Medium Term Financial Plan		**2.562**

27. This statement concludes that the Treasury Management budget is forecast to underspend by £0.385m 2005/06, with the surplus being returned to Council balances.

Conclusion

28. The prudential indicators have been updated to take account of the Council's borrowing position. However, maximum borrowing levels (the authorised limit and operational boundary, the key indicators) remain unchanged. The Councils return on investments has been satisfactory for the first six months of the current financial year. Based on the first six months of 2005/06 the Council's borrowing and investments is forecast to produce a saving of £0.385m on the 2005/06 approved budget.

Outcome of Consultation

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

Legal Implications

30. 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

31. 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

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

Decision Deadline

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

Key Decisions

34. This report does not represent a key decision.

Recommendation

35. 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

36. 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

(i) Capital Medium Term Financial Plan 2005/06 – 2008/09
(ii) Accounting Records
(iii) The Prudential Code for Capital Finance in Local Authorities

Elaine Hufford: Extension 2447