
**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

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.

Summary

2. With regard to the Prudential Indicators although there are changes, which reflect the movement in the Capital Programme, the Operational and Authorised Limits for borrowing remain unchanged. The report also shows that the Council's return on investments has been satisfactory. There are significant savings of £0.938m on the Treasury Management Budget mainly due to increased investment interest received and reductions in debt repayments, for both principal and interest.

Background - Prudential Code

3. The new Prudential Code for Capital Finance in local Authorities began on 1 April 2004 and introduced a greater freedom for the Council's capital expenditure. Part of the requirements of the Code is for reporting procedures to be implemented to monitor the progress and status of the capital expenditure plans. This report fulfils that requirement. The indicators were first reported to Council on 10th March 2004.

Information and Analysis

Recent changes to Capital Expenditure by Service

4. **Table 1** shows the first Prudential Indicator which highlights the actual 2003/04 position and changes between the original capital programme and the current position for 2004/05 to 2006/07. The changes to the 2004/05 capital expenditure estimates have been notified to Cabinet as part of the Capital Budget Monitoring process.

Table 1

Capital Expenditure by Service	2003/04	2004/05	2004/05	2004/05	2005/06	2005/06	2005/06	2006/07	2006/07	2006/07
	Actual	Original Estimate	Revised Estimate	Variance	Original Estimate	Revised Estimate	Variance	Original Estimate	Revised Estimate	Variance
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
Education	5.333	6.989	13.607	6.618	6.129	6.129	0.000	2.615	2.615	0.000
Transport	4.271	9.139	5.534	-3.605	9.010	13.203	4.193	3.330	3.330	0.000
Other	6.622	3.621	13.424	9.803	5.624	5.624	0.000	6.386	6.386	0.000

Total non-HRA-	16.226	19.749	32.565	12.816	20.763	24.956	4.193	12.331	12.331	0.000
Total HRA -	7.196	5.454	6.901	1.447	5.552	8.552	3.000	5.366	8.366	3.000
Total	23.422	25.203	39.466	14.263	26.315	33.508	7.193	17.697	20.697	3.000

5. The main changes are detailed below:-

- (a) The original Prudential Indicators assumed that all the capital funding secured for 2003/04 would be expended that year. However, resources of c£13m have been carried forward from 2003/04 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 by Service for 2004/05.
- (b) In relation to the Darlington Eastern Transport Corridor, due to protracted completion of statutory procedures it is unlikely that the funding provisionally allocated to this scheme will be utilised during 2004/05. This funding is now projected to be incurred during 2005/06.
- (c) The Housing Option Appraisal, has recommended that ownership and management of the Housing Stock remains in house and up to £20m of prudential borrowing be undertaken to bring the Housing Stock up to the decent homes standard.

6. 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 2003/04 position is shown for comparative purposes.

Table 2

	2003/04	2004/05	2004/05	2004/05	2005/06	2005/06	2005/06	2006/07	2006/07	2006/07
	Actual	Original	Revised	Variance	Original	Revised	Variance	Original	Revised	Variance
	Estimate	Estimate	Estimate		Estimate	Estimate		Estimate	Estimate	
	£m									
Capital Expenditure										
<i>Total spend</i>	23.422	25.203	39.466	14.263	26.315	33.508	7.193	17.697	20.697	3.000
Financed by:										
<i>Borrowing</i>	8.216	10.493	14.080	3.587	10.196	13.196	3.000	5.900	8.900	3.000
<i>Capital receipts</i>	3.327	1.013	3.635	2.622	2.780	2.780	0.000	1.180	1.180	0.000
<i>Capital grants</i>	11.518	13.597	20.311	6.714	13.239	17.432	4.193	10.517	10.517	0.000
<i>Capital Reserves</i>	0.000	0.000	0.259	0.259	0.000	0.000	0.000	0.000	0.000	0.000
<i>Capital Contribution</i>	0.345	0.100	0.471	0.371	0.100	0.100	0.000	0.100	0.100	0.000
<i>Revenue</i>	0.016	0.000	0.710	0.710	0.000	0.000	0.000	0.000	0.000	0.000
Prudential Indicator - Capital Financing Requirement										
CFR - Non Housing	35.793	46.625	47.259	0.634	54.453	54.352	-0.101	57.835	52.712	-5.123
CFR Housing	24.006	30.117	25.188	-4.929	31.330	29.401	-1.929	32.330	37.378	5.048
Total CFR	59.799	76.742	72.447	-4.295	85.783	83.753	-2.030	90.165	90.090	-0.075
<i>Net movement in CFR</i>		16.943	12.648	-4.295	9.041	7.011	-2.030	4.382	4.307	-0.075
Prudential Indicator - External Debt*										
Borrowing	62.230	70.337	74.878	4.541	79.378	86.184	6.806	83.760	92.910	9.150
Other long term liabilities	0.000	11.042	0.000	-11.042	10.352	0.000	-10.352	9.622	0.000	-9.622
Total Debt 31 March	62.230	81.379	74.878	-6.501	89.730	86.184	-3.546	93.382	92.910	-0.472

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 2004/05 and next two financial years. This allows some flexibility for limited early borrowing for future years.

Table 3

	2003/04	2004/05	2004/05	2004/05	2005/06	2005/06	2005/06	2006/07	2006/07	2006/07
	Actual	Original	Revised	Variance	Original	Revised	Variance	Original	Revised	Variance
	Estimate	Estimate	Estimate		Estimate	Estimate		Estimate	Estimate	
	£m									
Gross Borrowing	62.230	81.379	74.878	-6.501	89.730	86.184	-3.546	93.382	92.910	-0.472
Investments	29.570	23.900	25.901	2.001	22.700	22.923	0.223	23.200	22.078	-1.122
Net Borrowing	32.660	57.479	48.977	-8.502	67.030	63.261	-3.769	70.182	70.832	0.650
CFR	59.799	76.742	72.447	-4.295	85.783	83.753	-2.030	90.165	90.090	-0.075

9. The Director of Corporate Services reports that the Council complied with the requirement to keep net borrowing below the relevant CFR in 2003/04, 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).
- (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	2003/04	2004/05	2004/05	2004/05	2005/06	2005/06	2005/06	2006/07	2006/07	2006/07
	Actual	Original	Revised	Variance	Original	Revised	Variance	Original	Revised	Variance
	Estimate	Estimate	Estimate		Estimate	Estimate		Estimate	Estimate	
	£m									
Authorised Limit	0.000	97.035	97.035	0.000	106.640	106.640	0.000	110.840	110.840	0.000
Operational Boundary	72.342	84.379	84.379	0.000	92.730	92.730	0.000	96.382	96.382	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

	2003/04 Actual	2004/05 Original Estimate	2004/05 Revised Estimate	2004/05 Variance	2005/06 Original Estimate	2005/06 Revised Estimate	2005/06 Variance	2006/07 Original Estimate	2006/07 Revised Estimate	2006/07 Variance
Non-HRA	2.10%	2.67%	1.79%	-0.88%	3.25%	3.22%	-0.03%	3.72%	3.71%	-0.01%
HRA	10.86%	11.68%	11.46%	-0.22%	11.45%	11.99%	0.54%	11.89%	13.48%	1.59%

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.

Table 6

	2003/04 Actual	2004/05 Original Estimate	2004/05 Revised Estimate	2004/05 Variance	2005/06 Original Estimate	2005/06 Revised Estimate	2005/06 Variance	2006/07 Original Estimate	2006/07 Revised Estimate	2006/07 Variance
Council Tax - Band D	£0.00	£3.90	£1.97	-£1.93	£7.04	£6.84	-£0.20	£11.10	£11.09	-£0.01

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.

Table 7

	2003/04 Actual	2004/05 Original Estimate	2004/05 Revised Estimate	2004/05 Variance	2005/06 Original Estimate	2005/06 Revised Estimate	2005/06 Variance	2006/07 Original Estimate	2006/07 Revised Estimate	2006/07 Variance
Weekly Housing Rents	£0.00	£0.00	£0.00	£0.00	£0.00	£0.00	£0.00	£0.00	£0.32	£0.32
Anticipated Revenue Savings	£0.00	£0.00	£0.00	£0.00	£0.00	£0.00	£0.00	£0.00	-£0.32	-£0.32
Net Effect on Weekly Housing Rents	£0.00	£0.00	£0.00	£0.00	£0.00	£0.00	£0.00	£0.00	£0.00	£0.00

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:

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.

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

Table 8

	2003/04 Actual	2004/05 Original Estimate	2004/05 Revised Estimate	2004/05 Variance	2005/06 Original Estimate	2005/06 Revised Estimate	2005/06 Variance	2006/07 Original Estimate	2006/07 Revised Estimate	2006/07 Variance
Prudential indicator limits based on debt net of investments										
Limits on fixed interest rates		100%	100%	0%	100%	100%	0%	100%	100%	0%
Limits on variable interest rates		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

	2003/04 Actual	2004/05 Original Estimate	2004/05 Revised Estimate	2004/05 Variance	2005/06 Original Estimate	2005/06 Revised Estimate	2005/06 Variance	2006/07 Original Estimate	2006/07 Revised Estimate	2006/07 Variance
Maturity Structure of fixed borrowing										
Under 12 months	0.4%	10%	10%	0%	10%	10%	0%	10%	10%	0%
12 months to 2 years	2.1%	10%	10%	0%	10%	10%	0%	10%	10%	0%
2 years to 5 years	0.0%	30%	30%	0%	30%	30%	0%	30%	30%	0%
5 years to 10 years	9.1%	50%	50%	0%	50%	50%	0%	50%	50%	0%
10 years and above	88.4%	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.

Table 10

	2003/04	2004/05	2004/05	2004/05	2005/06	2005/06	2005/06	2006/07	2006/07	2006/07
	Actual	Original	Revised	Variance	Original	Revised	Variance	Original	Revised	Variance
		Estimate	Estimate		Estimate	Estimate		Estimate	Estimate	
Maximum principal sums invested 364 days	£0.000m	£16.900m	£16.900m	£0.000m	£15.700m	£15.700m	£0.000m	£16.200m	£16.200m	£0.000m

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 2004 to 30th September 2004

Short Term Investments

20. Cash balances are invested on a daily basis to maximise the benefit of temporary surplus funds. A total of 142 investments were made in the period 1st April 2004 to 30th September 2004 totalling £99.79m. These were for varying periods and earned interest of £0.330m at an average daily rate of 4.42%.

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 remained at £19.90m. Some individual loans within the £19.90m have matured and been renewed during this period. The long term investments have earned interest of £0.431m for the first six months of 2004/05 at an average rate of 4.32%.

Investment returns measured against the Finance Service Plan

22. Naturally, 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 the short term investment achievements are above market expectations. However, the longer term investment returns fall short of the market

indicators. This is because most of the investments in this category were placed in the preceding 12 months when interest rates were lower than at present. Whereas, the average of indicators looks at current investment rates that could have been attained over the longer term this year. It is expected by the end of the financial year that the rate of return for longer term investments will be 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	4.42	4.32
Local Authority- 2 day	4.31	
Local Authority - 7 day	4.31	
Local Authority - 6 months		4.73
Local Authority - 12 months		4.98
London Inter Bank Bid Rate – 7 day	4.36	4.36
Average of all Indicators	4.32	4.69

Borrowing

24. To date during 2004-05 new loans of £5.000m has been taken with the Public Works Loan Board (PWLb) for a period of 30 years at an interest rate of 4.99%. This is in line with the Prudential Indicators and the Treasury Management Budget. Further loans will be 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 £15m and £19m which earns interest and represents the Councils 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 budget is consistently set on a conservative basis both in terms of quantum of money and the forecast in interest rates, particularly for cashflow interest. The combination of this cautious approach and proactive Treasury Management actions throughout the year normally results in an underspend. This underspend is used to offset any departmental

overspends with the residue going back to Council balances.

27. The Treasury Management budget has recently been reviewed and the following changes to the 2004/05 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 2004/05

Table 12

	£m	£m
Treasury Management Medium Term Financial Plan		2.827
<u>Changes in Debt Repayments (Principal and Interest)</u>		
Rescheduling of debt	-0.192	
Utilisation of Capital Receipts 2003/04 (Due to flexibility allowed by Prudential Borrowing)	-0.127	
Changes in the profile and size of the Capital Programme	-0.127	
<u>Total changes in Debt repayments (Principal and Interest)</u>		-0.446
<u>Changes in Investment Levels / Interest</u>		
New Investment Strategy increased returns (due to additional investment freedoms)	-0.038	
Increase Cashflow, investments from £7m to £10m	-0.144	
Higher returns on Investments	-0.246	
Increased / (Decreased) levels of Medium Term Investments	-0.064	
<u>Total Changes in Investment Interest / Levels</u>		-0.492
Total Financing Costs Savings		-0.938
Revised Treasury Management Medium Term Financial Plan		1.889

28. This statement concludes that the Treasury Management budget is forecast to underspend by £0.938m in 2004/05m, with the surplus being returned to Council balances.

Conclusion

29. The prudential indicators have been updated to take account of the Council's borrowing position. The main indicators for operational and authorised limits remain unchanged. The Council's return on investments has been satisfactory for the first six months of the current financial year. The Council's borrowing and investments will produce a saving of £0.938m on the 2004/05 approved budget.

Outcome of Consultation

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

Legal Implications

31. 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

32. 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

33. The prudential indicators are a matter that are required to be considered by Council.

Recommendation

34. Council are requested to:-
- (a) approve the revised prudential indicators and limits within the report in Tables 1 to 10; and
 - (b) note the Treasury Management half yearly review.

Reasons

35. 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 2004/05 – 2007/08
- (ii) Accounting Records
- (iii) The Prudential Code for Capital Finance in Local Authorities

Elaine Hufford: Extension 2447