CABINET
06 JANUARY 2009

ITEM NO. ....

PRUDENTIAL INDICATORS UPDATE AND TREASURY MANAGEMENT HALF-YEAR REVIEW

Responsible Cabinet Member –Councillor Stephen Harker, Resources Portfolio

Responsible Director – Paul Wildsmith, Director of Corporate Services

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SUMMARY REPORT

Purpose of the Report

1. This report seeks approval of revised Prudential Indicators and provides a half yearly review of the Council's borrowing and investment activities. Cabinet are requested to forward the revised indicators to Council for their approval and note the changes to MTFP with regard to the Treasury Management Budget.

Summary

2. The mandatory Prudential Code, which governs councils' borrowing, requires Council approval of controls, called Prudential Indicators, relating to capital spending and borrowing. Prudential Indicators are set in three statutory annual reports. This mid-year update follows Council's approval in February 2008 of the 2008-09 Prudential Indicators and Treasury Management Strategy.

3. The key proposed revisions to Prudential Indicators relate to: -

   (a) Higher capital expenditure in 2008-09, principally slippage from 2007-08;
   (b) Increased capital financing and borrowing requirements, as a result of the previously reported shortfall in planned capital receipts.

Recommendation

4. It is recommended that :-

   (a) The revised prudential indicators and limits within the report in Tables 1 to 11are 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

5. 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
   (d) To enable further improvements to be made in the Council's Treasury Management function.

Paul Wildsmith
Director of Corporate Services

Background Papers

Capital Medium term Financial Plan 2007/08
Accounting Record
The Prudential Code for Capital Finance in Local Authorities
Elaine Hufford : Extension 2447

S17 Crime and Disorder	This report has no implications for S17 Crime and Disorder
Health and Well Being	This report has no implications for the Councils Health and Well Being agenda
Sustainability	This report has no implications for the Councils Sustainability agenda
Diversity	This report has no implications for the Councils Diversity agenda
Wards Affected	All wards
Groups Affected	All groups
Budget and Policy Framework	This report must be considered by Council
Key Decision	This is a key decision
Urgent Decision	For the purposes of call in this report is not an urgent decision
One Darlington: Perfectly Placed	This report has no particular implications for the Sustainable Community Strategy

MAIN REPORT

Introduction

6. 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.

7. 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 Council must approve at the beginning of each year controls called 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.

8. 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 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

9. This is a statutory report and much of the content is in a prescribed format, which is relatively technical. A summary of the revised headline indicators is presented in **Table 1** below. More detailed explanations of each indicator and any proposed changes are contained in the report. The proposed revised indicators reflect the approved movement in the Capital MTFP since its inception in February 2008. They also reflect revised projections of the profile of spending and the means by which the programme is to be financed.

10. In light of the credit crunch and the downturn in the housing market, capital receipts that were expected to fund committed schemes have been replaced by corporate unsupported borrowing. It is estimated that this will be £5.500m in 2008/09, £1.500m in 2009/10 and £0.500m in 2010/11. These figures may reduce if more capital receipts are realised or increase if more capital expenditure is committed that is not externally funded. The costs of this borrowing will impact on the Council's general fund revenue budget through the increased financing costs, i.e. interest payments and the repayment of principal amounts. This additional borrowing is reflected in **Table 1.**

Table 1 – Summary of Key Prudential Indicators 2007/08 to 2010/11

	2007/08 Actual	2008/09 Original Estimate	2008/09 Revised Estimate	2009/10 Revised Estimate	2010/11 Revised Estimate
	£m	£m	£m	£m	£m
Capital Expenditure	41.319	38.415	62.388	37.908	30.562
Capital financing requirement	98.144	106.146	111.360	116.694	117.266
Operational boundary for external debt	101.285	108.146	113.360	118.694	119.266
Authorised limit for external debt	116.548	124.368	124.638	128.347	128.593
Ratio of financing costs to net revenue stream – General Fund	1.83%	1.79%	1.60%	2.94%	3.21%
Ratio of financing costs to net revenue stream –HRA	12.17%	12.20%	9.60%	12.18%	12.97%
Incremental impact of capital investment decisions on the band D Council Tax	Nil	Nil	£1.80	£14.28	£17.00
Incremental impact of capital investment decisions on Housing Rents levels	Nil	Nil	Nil	Nil	Nil

Capital Expenditure and Borrowing Indicators

11. **Table 2** shows the Prudential Indicator for levels of Capital Expenditure for 2007/08 to 2010/11. The changes to the 2008/09 capital expenditure estimates have been notified to Cabinet as part of the Capital Budget Monitoring process.

Table 2 – Capital Expenditure – Actual and Estimates 2007/08 to 2010/11

Capital Expenditure	2007/08 Actual	2008/09 Original Estimate	2008/09 Revised Estimate	2008/09 Variance	2009/10 Original Estimate	2009/10 Revised Estimate	2009/10 Variance	2010/11 Original Estimate	2010/11 Revised Estimate	2010/11 Variance
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
Total non-HRA-	29.870	26.981	49.904	22.923	19.933	27.948	8.015	22.922	23.422	0.500
Total HRA -	11.449	11.434	12.484	1.050	9.960	9.960	0.00	7.140	7.140	0.00
Total	41.319	38.415	62.388	23.973	29.893	37.908	8.015	30.062	30.562	0.500

12. The main changes are: -

    (a) The original Prudential Indicators assumed that all the capital funding secured for 2007/08 would be expended that year. Resources of £24.513m have, however, been carried forward from 2007/08.Some of this was slippage of planned spending, but the majority was not expected to be spent during 2007/08. This, together with other additional expenditure already approved by Members as part of the capital budget monitoring process, has increased the anticipated Capital Expenditure for 2008/09.
    (b) The total capital resources available to the Authority is £70.903m, as per the October Cabinet monitoring report, it is unlikely that this full amount will be incurred in 2008/09. Therefore, where the profile of spend is expected to cover more than 2008/09, future years Capital expenditure has been amended to reflect this profile.
    (c) A full reconciliation of the changes in Capital Expenditure is attached at **Appendix 1.**

Changes to the financing of the capital programme; actual and estimated capital financing requirement and external debt

13. **Table 3a** below draws together the main strategy elements of the capital plans, highlighting the externally funded (supported) and unsupported elements of the capital programme, and the expected financing arrangements for this capital expenditure. The net financing need for the year –(borrowing) is the total projected capital expenditure for the year, less all of the other forms of financing.

14. Key variances in this table relate to: -
    (a) The reduction in capital receipts expected during the year
    (b) Increased borrowing due to the reduction in capital receipts
    (c) Borrowing required to cover a grant used at the end of 2007/08, which enabled the Council to maximise its grant income
    (d) The housing Capital Programme was not budgeted to receive a revenue contribution during 2008/09 but this is now expected to be achieved.
    (e) The increase in capital grants relates to scheme that have slipped and new schemes.

15. The second half of the **Table 3b** 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. It is increased each year by any new borrowing need and decreased by any statutory revenue charge for the repayment of debt (Minimum Revenue Provision). The actual 2007/08 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 3a

	2007/08 Actual	2008/09 Original Estimate	2008/09 Revised Estimate	2008/09 Variance	2009/10 Original Estimate	2009/10 Revised Estimate	2009/10 Variance	2010/11 Original Estimate	2010/11 Revised Estimate	2010/11 Variance
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
Capital Expenditure										
Supported Spend	34.802	34.595	50.680	16.085	26.604	33.195	6.591	29.352	29.352	0.00
Unsupported Spend	6.517	3.820	11.708	7.728	3.289	4.713	1.424	0.710	1.210	0.500
Total spend	41.319	38.415	62.388	23.813	29.893	37.908	8.015	30.062	30.562	0.500
Capital receipts	0.757	5.196	2.492	-2.704	0.700	0.700	0.00	0.700	0.700	0.00
Capital grants	26.859	22.858	37.550	14.692	20.309	26.241	5.932	23.890	23.890	0.00
Capital Reserves	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Capital Contribution	1.191	1.871	3.322	1.451	0.00	0.010	0.010	0.00	0.00	0.00
Revenue	2.783	0.00	2.822	2.822	1.547	1.547	0.000	1.146	1.146	0.00
Net Financing Need for the year-Borrowing	9.729	8.490	16.202	7.552	7.337	9.410	2.073	4.326	4.826	0.500

Table 3b

	2007/08 Actual	2008/09 Original Estimate	2008/09 Revised Estimate	2008/09 Variance	2009/10 Original Estimate	2009/10 Revised Estimate	2009/10 Variance	2010/11 Original Estimate	2010/11 Revised Estimate	2010/11 Variance
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
CFR – Non Housing	68.853	71.292	77.356	6.064	72.263	80.288	8.025	72.533	81.296	8.763
CFR - Housing	29.291	34.855	34.004	-0.851	37.343	36.406	-0.937	37.287	35.970	-1.317
Total CFR	98.144	106.147	111.360	5.213	109.606	116.694	7.088	109.820	117.266	7.446
Net movement in CFR	4.675	8.003	13.216	5.213	3.459	5.334	1.875	0.214	0.572	0.358
Borrowing	101.242	106.147	111.360	5.213	109.606	116.694	7.088	109.820	117.266	7.446
Other long term liabilities	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Total Debt 31 March	101.242	106.147	111.360	5.213	109.606	116.694	7.088	109.820	117.266	7.446

Limits to Borrowing Activity

16. **Table 4** 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 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 2008/09 and next two financial years. This allows some flexibility for limited early borrowing for future years.

Table 4

	2007/08 Actual	2008/09 Original Estimate	2008/09 Revised Estimate	2008/09 Variance	2009/10 Original Estimate	2009/10 Revised Estimate	2009/10 Variance	2010/11 Original Estimate	2010/11 Revised Estimate	2010/11 Variance
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
Gross Borrowing	101.242	106.146	111.360	5.214	109.606	116.694	7.088	109.820	117.266	7.446
Investments	43.460	49.600	47.915	-1.685	42.200	42.358	0.158	41.300	41.475	0.175
Net Borrowing	57.782	56.546	63.445	6.899	67.406	74.336	6.930	68.520	75.791	7.271
CFR	98.144	106.146	111.360	5.214	109.606	116.694	7.088	109.820	117.266	7.446

17. The Director of Corporate Services reports that the Council complied with the requirement to keep net borrowing below the relevant CFR in 2007/08, 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.

18. **Table 5** shows the further two Prudential Indicators that control the overall level of borrowing. 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 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 to this indicator are proposed.

(b) **The operational boundary** –This indicator is based on the probable external debt during the course of the year; it is not an absolute 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. It is proposed that this limit be amended to reflect changes in the profile of spend.

Table 5

Authorised limit for external debt	2007/08 Actual	2008/09 Original Estimate	2008/09 Revised Estimate	2008/09 Variance	2009/10 Original Estimate	2009/10 Revised Estimate	2009/10 Variance	2010/11 Original Estimate	2010/11 Revised Estimate	2010/11 Variance
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
Authorised Limit	116.548	124.368	124.638	0.00	128.347	128.347	0.00	128.593	128.593	0.00
Operational Boundary	101.285	108.146	113.360	5.214	111.606	118.694	7.088	111.820	119.266	7.446

Affordability Prudential Indicators

19. **The ratio of financing costs to net revenue stream – Table 6** 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 in Non HRA are due to improvements in to the Authority's Treasury Management Budget as detailed at paragraph 34.The increases in future years relate to increased financing costs associated with additional prudential borrowing in lieu of capital receipts not achieved. The changes in the HRA line reflect the reduced actual use of prudential borrowing for that service as opposed to what was estimated.

Table 6

	2007/08 Actual %	2008/09 Original Estimate %	2008/09 Revised Estimate %	2008/09 Variance %	2009/10 Original Estimate %	2009/10 Revised Estimate %	2009/10 Variance %	2010/11 Original Estimate %	2010/11 Revised Estimate %	2010/11 Variance %
Non-HRA	1.83	1.79	1.60	0.19	2.12	2.94	0.82	2.24	3.21	0.97
HRA	12.17	12.20	9.60	2.60	14.22	12.18	-2.04	15.29	12.97	2.32

20. **The incremental impact of new capital investment decisions on the council tax –Table 7**. This indicator identifies the trend in the cost of changes in the three-year capital programme compared to the Council's original budget commitments. The figures shown below relate to the reduction in capital receipts through the downturn of the housing market and the recession, which has led to an increase in prudential borrowing to cover Capital schemes that were intended to be financed by Capital receipts from the sale of land. The new prudential borrowing has been classed as "Corporate" and the costs associated with this will not be covered by existing budgets. This new cost is divided by the Council Tax Base to give a new cost to be covered by Council Tax. Some other departmental unsupported borrowing is anticipated to be undertaken, in the form of invest to save schemes and replacing leasing with prudential borrowing, The repayment of this borrowing will be accommodated within Departmental resource allocations, which will therefore have no incremental effect on Council Tax.

Table 7

	2007/08 Actual £	2008/09 Original Estimate	2008/09 Revised Estimate	2008/09 Variance	2009/10 Original Estimate	2009/10 Revised Estimate	2009/10 Variance	2010/11 Original Estimate	2010/11 Revised Estimate	2010/11 Variance
Council Tax – Band D	Nil	Nil	£1.80	£1.80	Nil	£14.28	£14.28	Nil	£17.00	£17.00

21. **Incremental impact of capital investment decisions on housing rent levels – Table 8**. 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 Homes Standard. However the additional repayment costs are to be accommodated within the Housing Revenue Account resources, the increased financing charges will be compensated by a reduction in other management costs, therefore, there is no incremental effect on housing rent levels.

Table 8

	2007/08 Actual	2008/09 Original Estimate	2008/09 Revised Estimate	2008/09 Variance	2009/10 Original Estimate	2009/10 Revised Estimate	2009/10 Variance	2010/11 Original Estimate	2010/11 Revised Estimate	2010/11 Variance
Weekly Housing Rents	Nil	Nil	Nil	-	Nil	Nil	-	Nil	Nil	-

Treasury Management Prudential Indicators

22. 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.

23. There are four further indicators:-

    Upper Limits On Variable Rate Exposure – Table 9. 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. The council's portfolio of debt is currently all fixed to take advantage of low rates and to give stability to future years financing costs.

Table 9

	2007/08 Actual	2008/09 Original Limit	2008/09 Revised Limit	2008/09 Variance	2009/10 Original Limit	2009/10 Revised Limit	2009/10 Variance	2010/11 Original Limit	2010/11 Revised Limit	2010/11 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	9.40%	40%	40%	0%	40%	40%	0%	40%	40%	0%

24. **Maturity Structures of Borrowing** – **Table 10.** These gross limits are set to reduce the Council's exposure to large value fixed rate loans (which carry a fixed interest rate for the duration of the loan) falling due for refinancing within short periods. The higher limits for longer periods reflect the fact that longer maturity periods generally attract lower interest rates. **Appendix 2** shows the current maturity profile of debt held by the Council. Cabinet approved a review of borrowing in December 2008, which will change the maturity profile within the existing limits.

Table 10

	2007/08 Actual	2008/09 Original Limit	2008/09 Revised Limit	2008/09 Variance	2009/10 Original Limit	2009/10 Revised Limit	2009/10 Variance	2010/11 Original Limit	2010/11 Revised Limit	2010/11 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	5.94%	60%	60%	0%	60%	60%	0%	60%	60%	0%
5 years to 10 years	0%	80%	80%	0%	80%	80%	0%	80%	80%	0%
10 years and above	94.06%	100%	100%	0%	100%	100%	0%	100%	100%	0%

25. **Total Principal Funds Invested** – **Table 11**. 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 if they give better rates of return than shorter periods. It also allows some stability in the interest returned to the Authority.

Table 11

	2007/08 Actual	2008/09 Original Limit	2008/09 Revised Limit	2008/09 Variance	2009/10 Original Limit	2009/10 Revised Limit	2009/10 Variance	2010/11 Original Limit	2010/11 Revised Limit	2010/11 Variance
Maximum principal sums invested > 364 days	£10M	£15M	£15M	£0M	£15M	£15M	£0M	£15M	£15M	£0M

Treasury Management Activity from 1st April 2008 to 30th September 2008

Short Term Cashflow Investments

26. Cash balances are invested on a daily basis to maximise the benefit of temporary surplus funds. A total of 144 investments were made in the period 1st April 2008 to 30th September 2008 totalling £141.600M. These were for periods of between 1 and 364 days and earned interest of £0.677m at an average daily rate of 5.73%.

Long Term Capital Investments

27. The Council's reserves and capital receipts are invested for varying periods up to the maximum permitted time of 4 years. The investments have been at an average level of £25.450M. Some individual loans within the £25.450M have matured and been renewed during this period. The long-term investments have earned interest of £0.729M for the first six months of 2008/09 at an average rate of 5.72%.

Investment returns measured against the Finance Service Plan

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

29. As can be seen from **Table 12** below, the short term cashflow investments achievements are above market expectations. These 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. The long term capital investments are also above the long term indicators due to placing investments for longer periods of time when interest rates were higher than experienced recently. Interest rates are falling, but it is expected that our actual rate of return for long term should remain above the average indicators until the end of the year. The short term rate may, however, fall below the average indicators as LIBOR (London Inter Bank Offer Rate) rates are still above bank base rates by a larger margin than normal and our approach to investing is more cautious, therefore not always accessing the higher LIBOR rates.

Table 12

	Short Term Cashflow Investments %	Long Term Capital Investments %
Darlington Borough Council -Actual	**5.73**	**5.72**
External Comparators		
Local Authority- 2 day	5.07	
Local Authority - 7 day	5.07	
Local Authority - 6 months		5.82
Local Authority - 12 months		5.92
London Inter Bank Bid Rate – 7 day	5.04	5.04
Average of External Comparators	**5.06**	**5.59**

Borrowing

30. To date during 2008/09 1 new loan has been taken for 70 years for £3.000M fixed at 3.94% for the first 5 years. It is expected that further new loans will be new loans will be taken later this financial year.

31. As yet no debt rescheduling has taken place this year. Our advisors, Butlers, have indicated that there may be opportunities in the near future to take advantage of lower rates being offered on shorter term loans of up to 5 years.

Treasury Management Budget

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

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(a) Long term capital investments interest earned – a cash amount of c£25m, 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 long term capital 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.

(d) The Treasury Management budget has recently been reviewed and the following changes to the 2008/09 budget should now be made. These changes are as the result of proactive management decisions and increased interest rates during part of 2008/09 and the expectation that more debt will need to be taken before the end of the year to finance the Capital Programme in lieu of Capital receipts from land sales.

Changes to Treasury Management Budget 2008/09
Table 13

	£m	£m
Original Treasury Management Medium Term Financial Plan		**2.354**
Changes in Debt Repayments (Principal and Interest)		
Changes in the profile and size of the Capital Programme	0.196	
		0.196.
Changes to investment interest levels		
Increased interest rate on Capital investments	-0.136	
Reduced rate of interest for temporary cashflow investments	0.057	
		-0.079
Less Additional savings from Debt repaid at 31st March 2008		-0.208
Revised Treasury Management Medium Term Financial Plan		**2.263**
Projected reduction in net financing costs 2008-09		**0.091**

33. This statement concludes that the Treasury Management budget is forecast to achieve an improvement of £0.091m in 2008/09, which will be returned to Council balances.

Conclusion

34. The prudential indicators have been updated to take account of the Council's borrowing position. The key borrowing indicator (the Operational Boundary) has been increased to reflect the new profile of the Capital Programme. The Council's return on investments has been good, exceeding both of the targets set of matching external comparators for the first six months of the current financial year. Based on the first six months of 2008/09 the Council's borrowing and investments is forecast to achieve an improvement of £0.091m on the 2008/09 approved budget.

Outcome of Consultation

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