SECTION 11

11. SETTING PRUDENTIAL INDICATORS FOR 2005/2006

Introduction

11.1 The introduction of a new prudential system of borrowing in the 2003 Local Government Act gave new opportunities for councils to assess their requirements for capital spending, and not have them artificially restricted by nationally set credit approvals, as they were under the previous system. But it also brought new responsibilities on councils to ensure that:

- capital expenditure plans are affordable;
- all external borrowing and other long term liabilities are within prudent and sustainable levels; and
- treasury management decisions are taken in accordance with good professional practice.

11.2 Under regulations issued under the 2003 LGA, councils are required to follow the Prudential Code issued by CIPFA which sets out how councils ensure they use their new freedom responsibly. The code sets out indicators which councils are required to set before the beginning of each year, to monitor during the year, and to report on at the end of each year.

11.3 In setting their prudential limits, Members must have regard to:

(a) Affordability e.g. implications for council tax and council housing rents.

(b) Prudence and sustainability, e.g. implications for external borrowing.

(c) Value for money, e.g. options appraisal.

(d) Stewardship of assets, e.g. asset management planning.

(e) Service objectives, e.g. strategic planning for the authority.

(f) Practicality, e.g. achievability of the forward plan.

11.4 This section sets out proposed prudential limits for Brent for 2005/2006 and subsequent years, which Members are asked to agree. It also sets out the arrangements for monitoring the prudential indicators.

Affordability

11.5 The Code requires Members to consider the affordability of decisions on investment in council assets.

11.6 Affordability of capital expenditure cannot be isolated from the affordability of the council's overall revenue expenditure. Section 9 of this report set out proposed changes to the capital programme which ensure total forecast capital commitments are maintained at previously agreed levels. Revenue spending in 2005/2006 to fund unsupported borrowing is estimated at

£1.907m (see section 5), which is below the £2.090m forecast for 2005/2006 in the March 2004 budget report. The reason for this is that, although unsupported borrowing has been kept at forecast levels for 2004/2005 and 2005/2006, the average rate of interest the council pays on debt has reduced. Members should note however that unsupported borrowing will have a cumulative impact on the council's budget and, although costs are below previously forecast levels, they are growing at a rapid rate from £557k in 2004/2005, to £1.907m in 2005/2006, £3.270m in 2006/2007, £4.620m in 2007/2008, and £5.616m in 2008/2009.

11.7 The CIPFA code requires that the council estimates:

- capital financing charges as a proportion of net revenue stream for both the General Fund and Housing Revenue Account; and
- the incremental impact of changes to the capital programme on council tax and rents.

11.8 The required calculations for 2005/06, and the three subsequent years are set out in Table 11.1 below. The ratio of capital financing charges to spending in the General Fund falls from 6.2% in 2004/2005 to 5.8% in 2005/2006, but gradually rises again to 6.1% by 2008/09. The ratio of capital financing charges to spending in the HRA is estimated at 25.3% in 2004/05 (down from an original estimate of 28.4%) but is expected to increase as further supported borrowing is provided for the ALMO, peaking at 31.2% in 2008/09. We have calculated the incremental impact of the capital programme on council tax and rents on the basis of unsupported borrowing that the council is using and plans to use to fund the capital programme. In the case of council tax, this is at previously agreed levels. In the case of rents, the amount is zero because we have no immediate plans to use unsupported borrowing for HRA capital spending, although there may be a requirement for up to £10m unsupported borrowing for the South Kilburn Development in future years, with associated costs being met from additional rent income, and not therefore affecting general rent levels.

Table 11.1 Prudential Indicators of Affordability

	2004/05	2005/06	2006/07	2007/08	2008/09
Capital financing charges as a proportion of net revenue stream:					
- General Fund	6.2%	5.8%	5.9%	5.9%	6.1%
- HRA	25.3%	28.3%	30.3%	30.8%	31.2%
Impact of unsupported borrowing on:					
- Council tax at Band D	£6.01	£20.53	£35.20	£49.74	£60.47
- Weekly rent	-	-	-	-	-

11.9 Future years' projections of the overall General Fund revenue budget (Appendix K) indicate that the council needs to do more work in the immediate future to bring overall expenditure plans within acceptable limits, but this is within its historic capability. This may involve looking at levels of capital commitments in future years. Ultimately affordability remains a political judgement and Members need to assure themselves that the plans set out in the report are affordable in terms of council tax and rent increases.

Prudence and Sustainability

11.10 The issues of prudence and sustainability are closely related to that of affordability. Are borrowing levels sensible and prudent and sustainable over the longer period? In particular is borrowing set at a level to finance capital investment in total and not for other purposes?

11.11 The indicators for prudence and sustainability cover capital spending, external debt, and treasury management.

11.12 For *capital spending*, the prudential indicators are as follows:

- Planned capital spending on the General Fund and HRA (see Section 9);
- The estimated capital financing requirement for General Fund and HRA, reflecting the council's underlying need to borrow. This covers borrowing to fund past capital spending and in-year capital spending.

<u>Table 11.2 Prudential Indicators for Capital Spending</u>

	2004/05	2005/06	2006/07	2007/08	2008/09
Planned capital spending: - General Fund	£57.1m	£49.9m	£39.5m	£38.7m	£28.4m
- HRA	£27.8m	£40.5m	£6.2m	£6.2m	£6.2m
- Total	£84.9m	£90.4m	£45.7m	£44.9m	£34.6m
Estimated capital financing requirement for[1]: - General Fund	£229.9m	£241.3m	£258.9m	£274.7m	£279.5m
- HRA	£270.8m	£311.2m	£317.5m	£323.7m	£329.9m
- Total	£500.7m	£552.5m	£576.4m	£598.4m	£609.4m

11.13 For *external debt*, the prudential indicators are as follows:

- The authorised limit for external debt. This allows flexibility to carry out debt restructuring should opportunities arise. For example, it may be

[1] The Capital Financing Requirement estimates in this table are at 31st March of each year.

appropriate to borrow in advance of repaying the original debt. It is therefore set at £150m above the capital financing requirement;

- The operational boundary for external debt. This sets out the expected total of borrowing for each year. This is lower than the authorised limit and is a key management tool for in-year monitoring. It is set at a level that reflects the council's capital financing requirement, the level of the capital programme, and estimated requirements for cash flow. The boundary has been set at a level £50m above the capital financing requirement to allow for early borrowing where interest rates may rise. The CIPFA code accepts that the operational boundary may on occasions be breached temporarily but that a sustained or regular trend above the operational boundary would be significant and lead to further investigation and action as appropriate.
- Net borrowing. A key indicator of prudence is that net external borrowing – gross borrowing less investment – does not, other than in the short term, exceed the total capital financing requirement. This is to ensure that net borrowing is only used for capital purposes.

The authorized limit and operational boundary for 2005/2006 onwards have both been set below levels agreed for 2004/05, primarily because we now have experience of operating the prudential framework and we consider the amount of latitude permitted by the limits can be reduced.

Table 11.3 Prudential Indicators for External Debt

	2004/05	2005/06	2006/07	2007/08	2008/09
Authorised limit for external debt	£850m	£700m	£730m	£750m	£760m
Operational boundary for external debt	£650m	£600m	£630m	£650m	£660m
Net borrowing	Below CFR	Below CFR	Below CFR	Below CFR	Below CFR

11.14 For *treasury management*, the prudential indicators are as follows:

- Adoption of the CIPFA Code of Practice for Treasury Management. This was adopted by the Council in September 2002. Amongst other things, it requires publication of an annual treasury management strategy and investment strategy, which are set out in section 10 of this report;
- Exposure to changes in interest rates:
  - Upper limit on net borrowing at fixed interest rates. This has been set at 100% on the basis that all net borrowing may be at fixed rates if it is anticipated that short-term rates are set to rise and long-term rates are perceived to be low. Variable interest borrowing would be retained up to the level of any variable interest investments;

- Upper limit on net borrowing at variable rates. This has been set at 40%. Variable rate borrowing is held as a hedge against variable rate investments. It also may be held where variable interest rates are low compared to fixed rates and fixed rates are expected to fall. The upper limit has also been set with debt restructuring in mind.

- Maturity structure of borrowing. Upper and lower limits on proportion of fixed interest loans that mature in:
  - Under 12 months;
  - Between 12 months and 24 months;
  - Between 24 months and 5 years;
  - Between 5 and 10 years;
  - 10 years and above

  The limits have been set to allow flexibility to manage loan durations but also to avoid having too much exposure to maturing loans in any period.

- Total investments. Upper limits on the amount invested for more than one year. Brent Council has not invested balances for periods of more than 364 days. The limit proposed allows flexibility to lend for longer periods if interest rates make this advantageous.

Table 11.4 Prudential Indicators for Treasury Management

	2004/05	2005/06	2006/07	2007/08	2008/09
Code of treasury management adopted	Yes	Yes	Yes	Yes	Yes
Exposure to interest rate changes:					
- Upper limit on fixed rate interest (% of net borrowing)	100%	100%	100%	100%	100%
- Upper limit on variable rate interest (% of net borrowing)	40%	40%	40%	40%	40%
Maturity of fixed interest loans:					
- Under 12 months:					
o Upper limit	40%	40%	40%	40%	40%
o Lower limit	0%	0%	0%	0%	0%
- Between 12 months and 24					

months: o Upper limit o Lower limit	 20% 0%	 20% 0%	 20% 0%	 20% 0%	 20% 0%
- Between 24 months and 5 years: o Upper limit o Lower limit	 20% 0%	 20% 0%	 20% 0%	 20% 0%	 20% 0%
- 5 years to 10 years: o Upper limit	30%	30%	30%	30%	30%
o Lower limit	0%	0%	0%	0%	0%
- 10 years and above: o Upper limit	90%	90%	90%	90%	90%
o Lower limit	30%	30%	30%	30%	30%
Upper limit on Investments of more than one year:	£50m	£50m	£50m	£50m	£50m

Achieving Value for Money

11.15 Members also need to consider achievement of value for money. There are many potential capital projects that are not value for money and the prudential code prohibits borrowing for such purposes. In Brent value for money is addressed in a number of ways including:

(a) Projects are initially vetted by the Capital Board for amongst other things value for money before being recommended for inclusion in the Capital Programme.

(b) The Capital Strategy requires all projects to be internally assessed for VFM before being submitted.

(c) Major projects require approval by the Executive and reports to Executive have to address VFM considerations.

(d) Standing orders ensure that letting of contracts is subject to appropriate competitive processes.

(e) Internal and external audit assess systems to ensure that appropriate processes are in place in identifying capital projects.

Proper Stewardship of Assets

11.16 The Code also requires consideration of stewardship of assets. The capital programme must deliver properly maintained assets and should not lead to acquisition of assets which put a strain on the council's ability to achieve this objective for all its stock. The council has developed an asset management plan for its general fund assets and a long term business plan for HRA stock which identifies the investment needs to keep assets to an appropriate standard. The long term business plans for the General Fund and HRA demonstrate that sufficient resources are available to maintain this stock at an affordable level.

11.17 The capital programme as a whole is linked to the Corporate Strategy and other plans and objectives of the council. This is a key criterion for the Capital Board before projects can be recommended for inclusion in the Capital Programme. The service development planning process ensures that spend on revenue and capital is linked to the council's overall objectives. The budget approval process gives Members a final opportunity to check that this objective has been met.

Practicality

11.18 This is the last of the issues Members have to consider in setting prudential indicators. Is the capital programme set out in section 9 of this report capable of delivery? Is it practical? The expansion of the capital programme in 2004/2005 raised issues of capacity to delivery. Additional resources were included in the 2004/2005 budget to address the capacity issue particularly in the areas of Education, Social Services and Corporate Services. Whilst there has been some slippage in the 2004/2005 capital programme, a substantial proportion of it has been delivered already and further schemes will be completed before the end of the financial year.

11.19 For 2005/2006, the capital programme remains broadly at the level agreed for 2004/2005. The Capital Board will continue to meet monthly to monitor implementation of the delivery of the programme and require action to be taken where there is delay. Members need to be satisfied that adequate arrangements are in place to ensure delivery of the programme before they agree to the capital programme set out in section 9.

Monitoring and Reporting on Prudential Indicators

11.20 The CIPFA Code requires that prudential indicators are monitored during the year and reported at the end of the year as part of the final accounts.

11.21 The arrangements we have put in place for this are as follows:

- The probable actuals and estimates for all prudential indicators are reported as part of this budget report to the Executive and Full Council;
- Our report to the General Purposes Committee on the unaudited accounts will include details of the outturn on prudential indicators on affordability, capital spending, and external debt. Any amendments during audit will be included in our report to GPC on audited accounts.
- Prudential indicators on affordability and capital spending are reported in regular capital monitoring reports to the Executive.

- Prudential indicators on external debt and treasury management are monitored daily in BFS. The Director of Finance and Deputy Director of Finance review the figures on these indicators on a weekly basis. With the exception of the operational boundary, the limits cannot be breached. Any changes to the limits need to be agreed by Full Council.