SECTION 12

12. SETTING PRUDENTIAL INDICATORS FOR 2008/09

Introduction

12.1 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:

a. capital expenditure plans are affordable;

b. all external borrowing and other long term liabilities are within prudent and sustainable levels; and

c. treasury management decisions are taken in accordance with good professional practice.

12.2 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.

12.3 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.

12.4 This section sets out proposed prudential limits for Brent for 2008/09 and subsequent years, which Members are asked to agree. It also sets out the arrangements for monitoring the prudential indicators.

Affordability

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

12.6 Affordability of capital expenditure cannot be isolated from the affordability of the council's overall revenue expenditure. Section 10 of this report set out proposed changes to the capital programme which ensure total forecast capital commitments are maintained at previously agreed levels. General Fund revenue spending in 2008/09 to fund unsupported borrowing is estimated at £3.769m (see section 10). Members should note however that unsupported borrowing will have a cumulative impact on the council's budget and the costs of funding it are growing at a rapid rate from £2.473m in 2007/08, to £3.769m in 2008/09, £5.135m in 2009/10, £6.003m in 2010/11, and £6.806m in 2011/12.

12.7 The CIPFA code requires that the council estimates:

a. capital financing charges as a proportion of net revenue stream for both the General Fund and Housing Revenue Account; and

b. the incremental impact of changes to the capital programme on council tax and rents.

12.8 The required calculations for 2008/09, and the three subsequent years are set out in Table 12.1 below. The ratio of capital financing charges to spending in the General Fund is 9.17% in 2007/08, rising to 9.44% by 2011/12. Capital financing charges within the HRA fall as a proportion the budget over the same period, reflecting the relatively low level of borrowing currently assumed within the HRA. The impact on Council Tax at Band D of unsupported borrowing was set out in Section 10. These figures should be treated with some caution because changes to the revenue grant regime – and in particular absence of funding for so-called 'supported' borrowing for councils on the grant floor – mean that the impact of 'supported' borrowing and 'unsupported' borrowing on the council's future financial plans is broadly similar. Members should also note that this calculation does not take account of the provision made for self-supported borrowing of up to £25m to enable property acquisitions by the council detailed in Section 10. These acquisitions will only proceed if borrowing costs are offset by reduced leasing costs met by the council and/or additional rental income.

Table 12.1 Prudential Indicators of Affordability

	2007/08	2008/09	2009/10	2010/11	2011/12
Capital financing charges as a proportion of net revenue stream: - General Fund	9.50%	9.27%	9.21%	9.37%	9.24%
- HRA	34.28%	33.72%	33.79%	33.81%	33.77%
Impact of unsupported borrowing on: - Council tax at Band D	£26.16	£39.85	£54.29	£63.48	£71.96
- Weekly rent	-	-	-	-	

12.9 Future years' projections of the overall General Fund revenue budget indicate that the council needs to do more 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

12.10 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?

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

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

- Planned capital spending on the General Fund and HRA (see chapter 10);
- 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.

Table 12.2 Prudential Indicators for Capital Spending

	2007/08 £m	**2008/09 £m**	**2009/10 £m**	**2010/11 £m**	**2011/12 £m**
Planned capital spending:					
- General Fund	81.555	89.293	56.228	59.175	30.811
- HRA	22.244	14.441	7.284	7.284	7.284
- Total	103.799	103.734	63.512	66.459	38.095
Estimated capital financing requirement for[1]:					
- General Fund	272.903	325.374	335.157	342.842	348.727
- HRA	326.391	326.991	327.591	328.191	328.791
- Total	599.294	652.365	662.748	671.033	677.518

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

a. The authorised limit for external debt. This allows flexibility to carry out debt restructuring should opportunities arise. For example, it may be appropriate to borrow in advance of repaying the original debt. It is therefore set at approximately £175m above the capital financing requirement.

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

b. 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 is set at a level approximately £75m above the capital financing requirement (CFR) to allow for early borrowing either for restructuring or 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.

c. 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.

Table 12.3 Prudential Indicators for External Debt

	2007/08 £m	2008/09 £m	2009/10 £m	2010/11 £m	2011/12 £m
Authorised limit for external debt	780	825	835	845	855
Operational boundary for external debt	680	725	735	745	755
Net borrowing	Below CFR	Below CFR	Below CFR	Below CFR	Below CFR

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

a. 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 11 of this report;

b. Exposure *to changes in interest rates:*

- o *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;
- o *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.

c. *Maturity structure of borrowing.* Upper and lower limits on proportion of fixed interest loans that mature in:

- o Under 12 months;
- o Between 12 months and 24 months;
- o Between 24 months and 5 years;
- o Between 5 and 10 years;
- o 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.

d. *Total investments.* Upper limits on the amount invested for more than one year. The limit proposed allows flexibility for either external managers or the in-house team to lend for longer periods if interest rates make this advantageous.

Table 12.4 Prudential Indicators for Treasury Management

	2007/08	2008/09	2009/10	2010/11	2011/12
Treasury Management Code 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 o Lower limit	40% 0%	40% 0%	40% 0%	40% 0%	40% 0%
- Between 12 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 to 10 years:					

	2007/08	2008/09	2009/10	2010/11	2011/12
o Upper limit o Lower limit	60% 0%	60% 0%	60% 0%	60% 0%	60% 0%
- 10 years and above: o Upper limit o Lower limit	 100% 30%	 100% 30%	 100% 30%	 100% 30%	 100% 30%
Upper limit on Investments of more than one year:	£60m	£60m	£60m	£60m	£60m

Achieving Value for Money

12.15 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

12.16 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.

12.17 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

12.18 This is the last of the issues Members have to consider in setting prudential indicators. Is the capital programme set out in Section 10 of this report capable of delivery? Is it practical?

12.19 In 2008/09, 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. Section 10 has also set out the main risks associated with the capital programme and how these will be managed.

Monitoring and Reporting on Prudential Indicators

12.20 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.

12.21 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;
- The report to the Executive on the capital outturn includes 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 also reported in Performance and Finance Review reports to the Executive.
- Prudential indicators on external debt and treasury management are monitored daily in Finance and Corporate Resources. The Director of Finance and Corporate Resources and Deputy Director of Finance and Corporate Resources review the figures on these indicators on a weekly basis. Any forecast of a breach of the limits or actual breach of the limits will be reported at the first opportunity to General Purposes Committee. The only exception to this is breaches of the operational boundary on borrowing which will be reported in the next budget monitoring report to the Executive (unless they are sustained in which case they will be reported on an exception basis to General Purposes Committee).