



NOTTINGHAMSHIRE
Fire & Rescue Service
Creating Safer Communities

Nottinghamshire and City of Nottingham
Fire and Rescue Authority

PRUDENTIAL CODE FOR CAPITAL FINANCE 2011/12

Joint Report of the Treasurer and Chief Fire Officer

Agenda Item No:

Date: 25 February 2011

Purpose of Report:

To inform Members of the Authority's obligations under the CIPFA Prudential Code for Capital Finance.

To seek the approval of Members to the proposed capital plans, prudential limits, and monitoring processes set out in the report.

CONTACT OFFICER

Name : Neil Timms
Head of Finance and Resources

Tel : 0115 967 0880

Email : neil.timms@notts-fire.gov.uk

Media Enquiries Contact Elisabeth Reeson
0115 967 5889 elisabeth.reeson@notts-fire.gov.uk

1. BACKGROUND

- 1.1 The Local Government Act 2003 set out a framework for the financing of capital investments in local authorities which came into operation from April 2004. Alongside this, the Prudential Code was developed by the Chartered Institute of Public Finance and Accountancy (CIPFA) as a professional code of practice to support local authorities' decision making in the areas of capital investment and financing. Authorities are required by regulation to have regard to the Prudential Code, which CIPFA updated in 2009.
- 1.2 The objectives of the Prudential Code are to ensure that the capital investment plans of authorities are affordable, prudent and sustainable and that treasury management decisions are taken in accordance with good professional practice. In exceptional cases, the Code should provide a framework which will demonstrate where the objectives may not be ensured, so that timely remedial action can be taken.
- 1.3 The Prudential Code sets out a number of indicators which authorities must use to support decision making. These are not designed to be comparative performance indicators. In addition, the CIPFA Treasury Management code of practice and guidance notes (also updated in 2009) sets out a series of treasury indicators. The prudential and treasury indicators should be considered in parallel and they are therefore included together in this report.
- 1.4 This report sets out the proposed prudential and treasury limits for the Authority for the 2011/12 financial year along with the implications of the proposed Capital Programme, which will be presented with the budget report elsewhere on the agenda.
- 1.5 Reports which monitor the Authority's performance against these indicators will be presented to the Finance and Resources Committee throughout the year.

2. REPORT

PRUDENTIAL INDICATORS FOR AFFORDABILITY

- 2.1 Estimates of the Ratio of Financing Costs to Net Revenue Stream for 2010/11, 2011/12, 2012/13, 2013/14 and 2014/15 and Actual Ratio of Financing Costs for 2009/10

2009/10 Actual £000's	2010/11 Estimate £000's	2011/12 Estimate £000's	2012/13 Estimate £000's	2013/14 Estimate £000's	2014/15 Estimate £000's
Ratio of Financing Costs to Net Revenue Stream					
4.5%	5.3%	6.4%	7.0%	7.7%	8.0%

On 24 October 2008 the Finance and Resources Committee considered a report on Sustainable Capital Plans. This report concluded that in order to meet the Prudential Code requirements of affordability and sustainability, the ratio of financing costs to net revenue stream should not exceed 8%.

2.2 Estimates of the Incremental Impact of the New Capital Investment Decisions on the Council Tax (Band D) for 2011/12, 2012/13, 2013/14 and 2014/15

2011/12 Estimate £000's	2012/13 Estimate £000's	2013/14 Estimate £000's	2014/15 Estimate £000's
Incremental Impact on Council Tax			
£1.57	£0.91	£0.53	£0.31

PRUDENTIAL INDICATORS FOR PRUDENCE

2.3 Net Borrowing and the Capital Financing Requirement

This indicator requires that net external borrowing does not, except in the short term, exceed the total of the capital financing requirement estimated up to the end of 2014/15. Performance against this indicator will be monitored throughout the year.

2.4 Treasury Management

As required by this indicator, the Authority has adopted the CIPFA Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes.

PRUDENTIAL INDICATORS FOR CAPITAL EXPENDITURE AND EXTERNAL DEBT

2.5 Estimate of Total Capital Expenditure to be Incurred in 2010/11, 2011/12, 2012/13, 2013/14 and 2014/15 and Actual Capital Expenditure for 2009/10

2009/10 Actual £000's	2010/11 Estimate £000's	2011/12 Estimate £000's	2012/13 Estimate £000's	2013/14 Estimate £000's	2014/15 Estimate £000's
Capital Expenditure Total					
6,031	7,358	2,804	3,811	4,649	3,666
Capital Expenditure – Financed by Borrowing / Finance Lease					
4,948	3,230	0	2,030	3,437	3,411
Capital Expenditure – Financed by Revenue Contributions					
335	3,182	818	0	0	0
Capital Expenditure – Financed by Capital Grant					
738	946	1,486	0	0	0
Capital Expenditure – Financed by Capital Receipt					
10	0	500	1,781	1,212	255

The estimates for 2011/12 to 2014/15 are submitted to the Fire Authority for approval elsewhere on this agenda. Various financing methods have been assumed for the future years but in reality, decisions relating to financing methods will be taken as part of options analyses which will consider the best long term options for the Authority. These options need to be assessed at the time of financing.

2.6 Estimate of Capital Financing Requirement as at the end of 2010/11, 2011/12, 2012/13, 2013/14 and 2014/15 and Actual Capital Financing Requirement as at 31/03/10

2009/10 Actual £000's	2010/11 Estimate £000's	2011/12 Estimate £000's	2012/13 Estimate £000's	2013/14 Estimate £000's	2014/15 Estimate £000's
Capital Financing Requirement					
28,056	29,859	28,078	28,135	29,548	30,893

The Capital Financing Requirement is the sum of money required from external sources to fund Capital Expenditure, and represents the Authority's underlying need to borrow for capital purposes. It will therefore be the aggregate of all capital expenditure, less any revenue contributions, capital grants or capital receipts. It is also important to note that the actual requirements for capital financing in a year will depend to some extent upon the timing of the cash flows of the capital expenditure itself.

The Sustainable Capital Plans report referred to in paragraph 2.1 also concluded that in order to meet the Prudential Code requirements of affordability and sustainability, the capital financing requirement in future years should not exceed £40m.

Operational Boundary and Authorised Limit for External Debt

- 2.7 The Operational Boundary is the Authority's estimate of its total external debt, excluding investments but including other long-term liabilities which are separately identified. This is to reflect the most likely scenario and not the worst case. It is possible for the operational limit to be temporarily breached to take account of unusual movements in cash flow but this should not be a regular occurrence. A variation from the operational boundary is permissible, but will be reported to the Fire Authority.
- 2.8 The Authorised Limit is essentially the same as the Operational Boundary but allows headroom over and above it to take account of unusual movements in cash flow and therefore should be the maximum amount of external debt that the Authority is exposed to at any given time. Any proposed variation from the Authorised Limit must be authorised by the Fire Authority
- 2.9 Cash flow forecasts have been prepared for 2011/12 to 2014/15 and indicate that there will be no difficulty in maintaining a positive current account balance on a month by month basis and therefore there is no proposal to seek an increase in the Authority's approved overdraft limit of £200,000. However, previous experience shows that these estimates can sometimes be

wrong temporarily due to delays in income receipts and it has proved necessary in the past to negotiate temporary increases in this figure of up to £500,000. It is therefore proposed that this figure of £500,000 should be included within both the operational boundary and the authorised limit.

	2011/12 £000's	2012/13 £000's	2013/14 £000's	2014/15 £000's
Operational Boundary				
O.B. for borrowing	29,846	31,640	33,787	33,966
O.B. for other long term liabilities	916	879	844	810
Total - Operational Boundary for External Debt	30,762	32,519	34,631	34,776
Authorised Limit				
A.L. for borrowing	32,831	34,804	37,165	37,362
A.L. for other long term liabilities	1,008	967	929	892
Total - Authorised Limit for External Debt	33,839	35,771	38,094	38,254

2.10 Actual External Debt as at 31/03/10

	2009/10 £000's
Actual borrowing	24,658
Actual other long term liabilities	994
Total – Actual External Debt	25,652

INDICATORS FOR TREASURY MANAGEMENT

2.11 The Service carries out its own treasury management in accordance with the CIPFA Code of Practice for Treasury Management, which was revised in 2009. The Authority has adopted a low risk approach to treasury management, which seeks to ensure that investments are secure and that there is sufficient liquidity of funds to enable the Authority carry out its business.

Gross and Net Debt

2.12 The amount of actual external long term debt as at 31/03/10 was £24,658k, as reported in paragraph 2.10. In addition, short term debt as at the same date totalled £103k. At the same date, the amount of investments was £5,400k, giving a net debt position of £19,361k as at 31/03/10.

2.13 On 18 December 2009, the Fire and Rescue Authority considered and approved the recommendation in a paper entitled "Revision to Treasury

Management Strategy 2009/10". This recommendation was to return to the original strategy agreed for the year, which had been markedly tightened in the wake of the world economic and banking crisis. It was agreed that liquid investments should be in place to "cash-back" the Authority's reserves, thereby enabling those reserves to be used in practice. This reinstatement is taking place over three years by way of borrowing, and 2011/12 is the second year. The result will be a widening gap between the Authority's gross and net debt positions but it must be pointed out that this is not borrowing for the purpose of investment per se, but borrowing to reinstate liquid investments supporting the Authority's reserves, which have previously been realised and used to finance capital expenditure during the economic crisis.

- 2.14 The Treasury Management Strategy 2011/12 report, which is elsewhere on this agenda, outlines the proposal to use the Authority's surplus balances to partially finance new capital expenditure by way of revenue contributions. The impact of this will be to reduce ongoing revenue costs in future years. There will still be a need to borrow at various times over the next four years, and the decision about when to borrow and when to use revenue contributions to fund the capital programme will depend upon interest rate forecasts. For the purposes of setting indicators, assumptions have been made about when borrowing may take place – the reality of this will be determined by Officers in conjunction with the Authority's treasury advisers.

Interest Rate Risk Exposure

- 2.15 In terms of borrowing, it has been considered prudent to use Public Works Loans Board (PWLB) fixed interest loans on most occasions. This is because the PWLB generally offers rates which cannot be obtained elsewhere in the marketplace. However the Authority did take out a market loan in 2007/08, benefiting from an advantageous rate. Unlike lending, borrowing is a low risk activity so future borrowing arrangements will be entered into on the basis of what is most advantageous for the Authority at the time. Any proposals to borrow from alternative sources to the PWLB will be discussed and agreed with the Treasurer.
- 2.16 Borrowing in the past has been at fixed interest rates although variable rates are not ruled out. It is therefore considered that up to 30% of borrowing might come from variable rate sources if these are considered financially advantageous at the time of financing. For policy changes beyond this, however, it is suggested that Fire Authority approval should be sought.
- 2.17 The total value of lending is not expected to exceed £12,000,000, which will peak at the start of 2011/12 however it is difficult to assess what the likely investment profile might be as this depends upon capital expenditure timings. Current investments are all for less than 1 year and at rates fixed for short periods. The aim will be to reduce risk by investing funds in more than one institution at any given time. Members should note, however, that it is not feasible to set a maximum limit for investing with any one institution as the numbers of UK banks and building societies which meet our minimum credit

rating criteria is now very few and even those on the list will not always accept our investments as the Authority is a “small player”. It is expected that the total amount invested will reduce as the year progresses and capital expenditure is funded by revenue contributions.

- 2.18 It is proposed that the Authority sets the following limits for interest rate exposures:

	Benchmark %	2010/11 £000's	2011/12 £000's	2012/13 £000's	2014/15 £000's
Interest Rate Exposures					
Upper Limit for fixed rate exposures	100%	100%	100%	100%	100%
Upper Limit for variable rate exposures	30%	30%	30%	30%	30%

Loan Maturity

- 2.18 The code of practice and CIPFA guidelines state that there should be no direct linkage between the assets financed and the term of loans taken out. Upper limits in terms of loan maturity are set to ensure that the Authority is not exposed to the risk of having to repay loans and then re-borrow in the short term when interest rates might be high.

Limits on the Maturity Structure of Borrowing		
	Upper Limit	Lower Limit
Under 12 months	20%	0%
12 months to 5 years	30%	0%
5 years to 10 years	75%	0%
10 years to 20 years	100%	20%
Over 20 years	100%	20%

- 2.19 Principal Sums Invested for Periods Longer than 364 Days

Investments arising from borrowing to support the capital programme are unlikely to exceed one year in duration, however for borrowing to reinstate reserves as explained in paragraph 2.13 it may be desirable to invest monies for a slightly longer period to achieve a level of certainty around interest receipts and perhaps beneficial interest rates. Such decisions will be influenced by market conditions at the time and the liquidity of funds will be of paramount importance. It is proposed that Officers should be able to invest monies for longer than a year if this appears to be an advantageous strategy, but that a maximum limit of £2m be applied to any such investments. This will contain the Authority's exposure to the possibility of loss arising from having to seek early repayment of investments.

2011/12 £000's	2012/13 £000's	2013/14 £000's	2014/15 £000's
Prudential Limits for Principal Sums Invested for Periods Longer than 364 Days			
2,000	2,000	2,000	2,000

3. FINANCIAL IMPLICATIONS

The financial implications are set out in full within the body of the report.

4. PERSONNEL IMPLICATIONS

There are no specific personnel implications which arise directly from this report.

5. EQUALITY IMPACT ASSESSMENT

This is not a new policy or service, so no initial assessment has been completed. A previous assessment has shown that there are no specific equality impacts which arise directly from the Prudential Code.

6. CRIME AND DISORDER IMPLICATIONS

There are no specific crime and disorder implications which arise directly from this report.

7. RISK MANAGEMENT IMPLICATIONS

The risk exposures in this report relate primarily to three areas:

- The risk of over exposure of the Authority to interest rate fluctuations.
- The risk that the Authority has an unmanageable or unaffordable level of borrowing.
- The risk of tying up investments, thereby reducing liquidity and exposing the Authority to possible losses arising from early repayment of investments.

This paper serves to set out those risks and ensure that they are managed.

8. RECOMMENDATIONS

That Members approve the Prudential Limits for 2011/12 as follows:

Estimate of Ratio of Financing Costs to Net Revenue Stream	6.4%
Estimate of the Incremental Impact of the New	£1.57

Capital Investment Decisions on the Council Tax (Band D)	
Estimate of Total Capital Expenditure to be Incurred	£2,804,000
Estimate of Capital Financing Requirement	£28,078,000
Operational Boundary	£30,762,000
Authorised Limit	£33,838,000
Upper limit for fixed rate interest exposures	100%
Upper limit for variable rate interest exposures	30%
Loan Maturity:	<u>Limits:</u>
Under 12 months	Upper 20% Lower 0%
12 months to 5 years	Upper 30% Lower 0%
5 years to 10 years	Upper 75% Lower 0%
Over 10 years	Upper 100% Lower 20%
Over 20 years	Upper 100% Lower 20%
Upper Limit for Principal Sums Invested for Periods Longer than 364 Days	£2,000,000

Frank Swann
CHIEF FIRE OFFICER

Peter Hurford
TREASURER TO THE FIRE AUTHORITY