NOTTINGHAMSHIRE
Fire & Rescue Service
Creating Safer Communities

Nottinghamshire and City of Nottingham
Fire and Rescue Authority

PRUDENTIAL CODE FOR CAPITAL FINANCE 2013/14

Joint Report of the Treasurer and Chief Fire Officer

Agenda Item No:

Date: 22 February 2013

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.

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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 2011.

1.2 The objectives of the Prudential Codeare to ensure that the capital investment plans of authorities are affordable, prudent and sustainable and that treasury management decisions aretaken 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 Codesets 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 2011) 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 2013/14 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 2012/13, 2013/14, 2014/15 and 2015/16and Actual Ratio of Financing Costs for 2011/12

2011/12 Actual £000's	2012/13 Estimate £000's	2013/14 Estimate £000's	2014/15 Estimate £000's	2015/16 Estimate £000's
Ratio of Financing Costs to Net Revenue Stream				
6.3%	6.3%	5.5%	5.6%	5.5%

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%. The table above shows that the use of revenue contributions to finance capital over the past two years has had the effect of reducing this ratio and keeping it within the 8% target.

2.2 Estimates of the Incremental Impact of the New Capital Investment Decisions on the Council Tax (Band D) for 2013/14, 2014/15 and 2015/16

2013/14 Estimate £000's	2014/15 Estimate £000's	2015/16 Estimate £000's
Incremental Impact on Council Tax		
-£1.31	-£0.10	+£0.34

The table above shows that the effect of financing capital expenditure from reserves in 2011/12, 2012/13 and 2013/14 is a reduction in the incremental impact on council tax. Beyond this, there is an incremental increase

PRUDENTIAL INDICATORS FOR PRUDENCE

2.3 Gross Borrowing and the Capital Financing Requirement

This indicator has been amended in the 2011 revision to the Prudential Code and the revision takes effect in the 2013/14 financial year. It used to be "Net Borrowing" i.e. borrowing minus investments but is now "Gross Borrowing". This indicator requires that external borrowing does not, except in the short term, exceed the total of the capital financing requirement estimated up to the end of 2015/16.Performance against this indicator will be monitored throughout the year.For information, at 31 March 2012 (2011/12 financial year), the Capital Financing Requirement was £27,372k, Net Borrowing (total borrowing less investments) was £17,412k and Gross Borrowing was £27,630k. The estimate of the Capital Financing Requirement at the end of 2015/16 is £30,823k. The revision of this prudential indicator may well result in the Authority breaching the indicator in the short term and CIPFA has anticipated that this may be case for some Authorities, who must then explain the reasons for the potential breach. The reason why this Authority may not be able to keep Gross Borrowings below the Capital Financing Requirement in the short term is due to the structure of its borrowings. The majority of Authority loans are now maturity loans for which the principal sums are repaid at the end of the term and the decision to take out maturity loans has been based on advantageous interest rates at the time. The Authority has also made past decisions to gain longer term certainty by locking in lower interest rates on longer term loans. With the change in this indicator, the Authority will not be able to take account of cash set aside to repay loans on maturity and there may be some years when Gross Borrowing does exceed the Capital Financing Requirement. At the end of 2015/16, Gross Borrowings are expected to be in the region of £25.5m, with the Capital Financing Requirement estimated at £30.8m so although in the short term there may be a breach, in the medium term this indicator will be met. The Treasury

Management Strategy 2013/14, which is elsewhere on this agenda, will further address this issue.

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 2012/13, 2013/14, 2014/15 and 2015/16and Actual Capital Expenditure for 2011/12

2011/12 Actual £000's	2012/13 Estimate £000's	2013/14 Estimate £000's	2014/15 Estimate £000's	2015/16 Estimate £000's
Capital Expenditure Total				
2,879	4,634	5,762	4,164	4,880
Capital Expenditure – Financed by Borrowing / Finance Lease				
0	0	0	1,771	3,020
Capital Expenditure – Financed by Revenue Contributions				
1,368	2,200	2,000	0	0
Capital Expenditure – Financed by Internal Funds				
25	948	567	1,305	1,360
Capital Expenditure – Financed by Capital Grant				
1,486	1,486	1,088	1,088	500
Capital Expenditure – Financed by Capital Receipt				
0	0	2,107	0	0

The estimates for 2013/14 to 2015/16are submitted to the Fire Authority for approval elsewhere on this agenda. The capital expenditure estimate for 2013/14 shown in the above table includes assumed slippage from 2012/13. The final capital expenditure for each year may be different from the figures shown above but overall should be similar. 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. The table above assumes that in 2012/13 and 2013/14 a total of £4,200k of reserves will be used to finance capital expenditure. "Internal funds" in the above table refers to the use of cash available within budgeted resources generated by the minimum revenue provision charge, which is a non-cash transaction. Unused cash from this source is assumed to be carried forward for use in future years.

2.6 Estimate of Capital Financing Requirement as at the end of 2012/13, 2013/14, 2014/15 and 2015/16and Actual Capital Financing Requirement as at 31/03/12

2011/12 Actual £000's	2012/13 Estimate £000's	2013/14 Estimate £000's	2014/15Estimate £000's	2015/16 Estimate £000's
Capital Financing Requirement				
27,372	24,645	26,032	27,803	30,823

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. The above table shows that the Capital Financing Requirement reduces overall between 2011/12 and 2013/14 mainly due to the effect of revenue financing.

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, net of 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 boundary 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 2013/14 to 2015/16 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 buffer of £500,000 should be included within both the operational boundary and the authorised limit.

	2013/14 £000's	2014/15 £000's	2015/16 £000's
Operational Boundary			
O.B. for borrowing	27,130	27,130	29,130
O.B. for other long term liabilities	103	36	19
Total - OperationalBoundary for External Debt	27,233	27,166	29,149
Authorised Limit			
A.L. for borrowing	29,843	29,843	32,043
A.L. for other long term liabilities	113	39	21
Total - Authorised Limit for External Debt	29,956	29,882	32,064

2.10 Actual External Debt as at 31/03/12

	2011/12 £000's
Actual borrowing	27,630
Actual other long term liabilities	483
Total – Actual External Debt	28,113

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 2011. 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 actual amount of external long term debt as at 31/03/12was £25,540k,with short term debt totalling £2,090k.Other long term liabilities at the same date amounted to £483k. At the same date, the amount of investments was £10,582k, giving a net debt position of £17,531k as at 31/03/12.

2.13 The Treasury Management Strategy 2013/14 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 over the next three 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

2.14 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.

2.15 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.

2.16 The total value of lending is not expected to exceed £17m, which is likely to peakaroundJuly 2013 however it is difficult to assess what the likely investment profile might be as this depends upon capital expenditure timings as well as the level of pension top up grant received from the Department for Communities and Local Government. 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 banks 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".The Authority can also invest in Money Market Funds in line with the Treasury Management Strategy. It is expected that the total amount invested will reduce as the year progresses and capital expenditure is funded by revenue contributions.

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

	Benchmark %	2012/13 £000's	2013/14 £000's	2014/15 £000's	2015/16 £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.

2.19 It is recommended that the maturity structure limits remain unchanged for 2013/14. Projections of principal repayments for currently held loans show that by March 2015, the total proportion of loans with a repayment profile of above 20 years will be around 43% however the proportion of loans due to be repaid within 2 to 5 years will be around 48%, which will be a breach of the indicator. When borrowing does take place, it should therefore be for a longer term than 15 years to protect the Authority from future interest rate risk.

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%	0%
Over 20 years	100%	30%

2.20 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 surplus cash which supports reserves 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.

2013/14 £000’s	2014/15 £000’s	2015/16 £000’s
Prudential Limits for Principal Sums Invested for Periods Longer than 364 Days		
2,000	2,000	2,000

3. FINANCIAL IMPLICATIONS

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

4. HUMAN RESOURCES AND LEARNING AND DEVELOPMENT IMPLICATIONS

There are no specific human resources or learning and development implications which arise directly from this report.

5. EQUALITIES IMPLICATIONS

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. LEGAL IMPLICATIONS

There are no specific legal implications arising from this report.

8. 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 2013/14 as follows:

Estimate of Ratio of Financing Costs to Net Revenue Stream	5.5%
Estimate of the Incremental Impact of the New Capital Investment Decisions on the Council Tax (Band D)	-£1.31
Estimate of Total Capital Expenditure to be Incurred	£5,762,000
Estimate of Capital Financing Requirement	£26,032,000
Operational Boundary	£27,233,000
Authorised Limit	£29,956,000
Upper limit for fixed rate interest exposures	100%
Upper limit for variable rate interest exposures	30%
Loan Maturity:	Limits:
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 0%
Over 20 years	Upper 100% Lower 30%
Upper Limit for Principal Sums Invested for Periods Longer than 364 Days	£2,000,000

10. BACKGROUND PAPERS FOR INSPECTION (OTHER THAN PUBLISHED DOCUMENTS)

None.

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