NOTTINGHAMSHIRE
Fire & Rescue Service
Creating Safer Communities

Nottinghamshire and City of Nottingham
Fire and Rescue Authority

PRUDENTIAL CODE FOR CAPITAL FINANCE 2015/16

Joint Report of the Treasurer and Chief Fire Officer

Date: 27 February 2015

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 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 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 2015/16 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 2014/15, 2015/16, 2016/17 and 2017/18,and Actual Ratio of Financing Costs for 2013/14**

2013/14 Actual £000s	2014/15 Estimate £000s	2015/16 Estimate £000s	2016/17 Estimate £000s	2017/18 Estimate £000s
Ratio of Financing Costs to Net Revenue Stream				
7.3%	5.0%	5.3%	5.9%	6.9%

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 despite significant reductions in the net revenue stream (revenue budget).

2.2 Estimates of the Incremental Impact of the New Capital Investment Decisions on the Council Tax (Band D) for2013/14, 2014/15, 2015/16 and 2016/17

2014/15 Estimate £000s	**2015/16 Estimate £000s**	**2016/17 Estimate £000s**	**2017/18 Estimate £000s**
Incremental Impact on Council Tax			
-£3.97	£0.18	£0.96	£1.58

The table above shows that the effect of financing capital expenditure from reserves in 2011/12, 2012/13 and 2013/14, and the use of capital receipts in 2013/14, is a significant reduction in the incremental impact on council tax in 2014/15. Beyond this, there are small incremental increases which reflect the impact on the revenue budget of financing the capital programme.

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 took 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 2017/18.Performance against this indicator will be monitored throughout the year.For information, at 31 March 2014 (2013/14 financial year), the Capital Financing Requirement was £22,751k, Net Borrowing (total borrowing less investments) was £12,411kand Gross Borrowing was £22,476k. The estimate of the Capital Financing Requirement at the end of 2017/18 is £34,935k, thereby demonstrating that the indicator has not been breached.At the end of 2017/18, Gross Borrowings are expected to be in the region of £30m,with the Capital Financing Requirement estimated at £34.9mshowing that this indicator should be achievable.

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 2013/14, 2014/15, 2015/16 and 2016/17,and Actual Capital Expenditure for 2012/13**

2013/14 Actual £000s	2014/15 Estimate £000s	2015/16Estimate £000s	2016/17Estimate £000s	2017/18 Estimate £000s
Capital Expenditure Total				
3,327	6,438	4,869	6,015	4,290
Capital Expenditure – Financed by Borrowing / Finance Lease				
0	3,884	1,346	4,580	2,574
Capital Expenditure – Financed by Revenue Contributions				
1,652	0	0	0	0
Capital Expenditure – Financed by Internal Funds				
84	1,216	1,273	1,420	1,701
Capital Expenditure – Financed by Capital Grant				
1,591	1,088	0	0	0
Capital Expenditure – Financed by Capital Receipt				
0	250	2,250	15	15

The estimates for 2015/16 to 2017/18are submitted to the Fire Authority for approval elsewhere on this agenda. The capital expenditure estimate for 2015/16 shown in the above table includes assumed slippage from 2014/15. 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. “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 2013/14, 2014/15, 2015/16 and 2016/17,and Actual Capital Financing Requirement as at 31/03/13**

2013/14 Actual £000s	2014/15 Estimate £000s	2015/16 Estimate £000s	2016/17 Estimate £000s	2017/18 Estimate £000s
Capital Financing Requirement				
22,751	26,635	27,981	32,561	34,935

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 increases between 2013/14 and 2017/18, which is largely due to the lack of capital grant or revenue contributions available to fund the capital programme, resulting in a requirement for borrowing.

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 2015/16 to 2017/18 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.

	2015/16 £000s	2016/17 £000s	2017/18 £000s
Operational Boundary			
O.B. for borrowing	28,076	27,776	30,076
O.B. for other long term liabilities	0	0	0
Total - Operational Boundary for External Debt	28,076	27,776	30,076
Authorised Limit			
A.L. for borrowing	30,883	30,553	33,083
A.L. for other long term liabilities	0	0	0
Total - Authorised Limit for External Debt	30,883	30,553	33,083

2.10 **Actual External Debt as at 31/03/14**

	2013/14 £000s
Actual borrowing	22,476
Actual other long term liabilities	53
Total – Actual External Debt	22,529

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 borrowing as at 31/03/14 was £22,476k,with short term borrowingtotalling £2,068k.Other long term liabilities at the same date amounted to £53k.At the same date, the amount of investments was £10,065k, giving a net debt position of £12,411k as at 31/03/14.

2.13 The Treasury Management Strategy 2015/16 report, which is elsewhere on this agenda, outlines the proposal to borrow over the next three years to finance the capital programme and to replace maturing loans, and the decision about when to borrow 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 £26m, which is likely to peak aroundJuly 2015 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, and the timing of borrowing. 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.

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

	Benchmark %	**2014/15 %**	**2015/16 %**	**2016/17 %**	**2017/18 %**
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 2015/16.Projections of principal repayments for currently held loans show that it is likely that maturity structure limits will be breached next year until a new loan is taken. 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. New borrowing with maturity of around 35-45 years should be avoided due to the current structure of borrowing in the ‘over 20 years’ category.

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 365 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.

2015/16 £000s	**2016/17 £000s**	**2017/18 £000s**
Prudential Limits for Principal Sums Invested for Periods Longer than 365 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. EQUALITIESIMPLICATIONS

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

The Local Government Act 2003 imposes an obligation on the Authority to agree and monitor its prudential indicators.

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.

9. RECOMMENDATIONS

That Members approve the Prudential Limits for 2015/16 as follows:

Estimate of Ratio of Financing Costs to Net Revenue Stream	5.3%
Estimate of the Incremental Impact of the New Capital Investment Decisions on the Council Tax (Band D)	£0.18
Estimate of Total Capital Expenditure to be Incurred	£4,869,000
Estimate of Capital Financing Requirement	£27,981,000
Operational Boundary	£28,076,000
Authorised Limit	£30,883,000
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 365 Days	£2,000,000

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

None.

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CHIEF FIRE OFFICER

Peter Hurford
TREASURER TO THE FIRE AUTHORITY