



NOTTINGHAMSHIRE
Fire & Rescue Service
Creating Safer Communities

Nottinghamshire and City of Nottingham
Fire and Rescue Authority

PRUDENTIAL CODE FOR CAPITAL FINANCE 2014/15

Joint Report of the Treasurer and Chief Fire Officer

Date: 28 February 2014

Purpose of Report:

To inform Members of the Nottinghamshire 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 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 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 2014/15 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 2013/14, 2014/15, 2015/16 and 2016/17, and Actual Ratio of Financing Costs for 2012/13

2012/13 Actual £000's	2013/14 Estimate £000's	2014/15 Estimate £000's	2015/16 Estimate £000's	2016/17 Estimate £000's
Ratio of Financing Costs to Net Revenue Stream				
7.8%	5.6%	5.4%	6.1%	6.5%

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 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) for 2013/14, 2014/15, 2015/16 and 2016/17

2013/14 Estimate £000's	2014/15 Estimate £000's	2015/16 Estimate £000's	2016/17 Estimate £000's
Incremental Impact on Council Tax			
-£3.91	-£0.41	£0.69	£0.43

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 2013/14. 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 2016/17. Performance against this indicator will be monitored throughout the year. For information, at 31 March 2013 (2012/13 financial year), the Capital Financing Requirement was £25,004k, Net Borrowing (total borrowing less investments) was £13,468k and Gross Borrowing was £25,596k. The estimate of the Capital Financing Requirement at the end of 2016/17 is £29,427k. The revision of this prudential indicator has resulted in the Authority breaching the indicator in the short term and CIPFA has anticipated that this may be the case for some Authorities, who must then explain the reasons for the 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 2016/17, Gross Borrowings are expected to be in the region of £28.3m, with the Capital Financing Requirement estimated at £29.4m so although in the short term there has been a breach, in the medium term this indicator will be met. The Treasury Management Strategy 2014/15, 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 2013/14, 2014/15, 2015/16 and 2016/17, and Actual Capital Expenditure for 2012/13

2012/13 Actual £000's	2013/14 Estimate £000's	2014/15 Estimate £000's	2015/16 Estimate £000's	2016/17 Estimate £000's
Capital Expenditure Total				
2,430	4,952	6,281	4,696	4,544
Capital Expenditure – Financed by Borrowing / Finance Lease				
0	0	3,600	206	2,225
Capital Expenditure – Financed by Revenue Contributions				
814	1,729	0	0	0
Capital Expenditure – Financed by Internal Funds				
0	0	1,343	1,490	1,569
Capital Expenditure – Financed by Capital Grant				
1,616	1,088	1,088	750	750
Capital Expenditure – Financed by Capital Receipt				
0	2,135	250	2,250	0

The estimates for 2014/15 to 2016/17 are submitted to the Fire Authority for approval elsewhere on this agenda. The capital expenditure estimate for 2014/15 shown in the above table includes assumed slippage from 2013/14. 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 £2,543k 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 2013/14, 2014/15, 2015/16 and 2016/17, and Actual Capital Financing Requirement as at 31/03/13

2012/13 Actual £000's	2013/14 Estimate £000's	2014/15 Estimate £000's	2015/16 Estimate £000's	2016/17 Estimate £000's
Capital Financing Requirement				
25,004	23,396	26,996	27,202	29,427

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 2012/13 and 2013/14 mainly due to the effect of significant revenue financing during the three years to 2013/14.

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 2014/15 to 2016/17 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.

	2014/15 £000's	2015/16 £000's	2016/17 £000's
Operational Boundary			
O.B. for borrowing	26,346	30,346	28,346
O.B. for other long term liabilities	0	0	0
Total - Operational Boundary for External Debt	26,346	30,346	28,346
Authorised Limit			
A.L. for borrowing	28,981	33,381	31,181
A.L. for other long term liabilities	0	0	0
Total - Authorised Limit for External Debt	28,981	33,381	31,181

2.10 Actual External Debt as at 31/03/13

	2012/13 £000's
Actual borrowing	25,596
Actual other long term liabilities	53
Total – Actual External Debt	25,649

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 31/03/13 was £22,475k, with short term borrowing totalling £3,121k. Other long term liabilities at the same date amounted to £53k. At the same date, the amount

of investments was £12,128k, giving a net debt position of £13,521k as at 31/03/13.

- 2.13 The Treasury Management Strategy 2014/15 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 £17m, which is likely to peak around July 2014 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.

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

	Benchmark %	2013/14 £000's	2014/15 £000's	2015/16 £000's	2016/17 £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 2014/15. Projections of principal repayments for currently held loans show that by March 2014, the total proportion of loans with a repayment profile of between 1 and 5 years will be slightly over 30%, rising to 33% by March 2015. 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 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 personnel implications which arise directly from this report.

5. EQUALITIES IMPLICATIONS

An equality impact assessment has not been undertaken because this is not a new policy or service. 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 arising directly from this report.

7. LEGAL IMPLICATIONS

There are no legal implications arising directly 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.

9. RECOMMENDATIONS

It is recommended that Members approve the Prudential Limits for 2014/15 as follows:

Estimate of Ratio of Financing Costs to Net Revenue Stream	5.4%
Estimate of the Incremental Impact of the New Capital Investment Decisions on the Council Tax (Band D)	-£0.41
Estimate of Total Capital Expenditure to be Incurred	£6,281,000
Estimate of Capital Financing Requirement	£26,996,000
Operational Boundary	£26,346,000
Authorised Limit	£28,981,000
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 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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