WARDS AFFECTED: All **Item No**

AUDIT COMMITTEE
29 JULY 2011

REPORT OF DEPUTY CHIEF EXECUTIVE & CORPORATE DIRECTOR OF RESOURCES

TREASURY MANAGEMENT STRATEGY 2011/12 – REVISED PRUDENTIAL INDICATORS

1. PURPOSE OF REPORT

The City Council's treasury management function operates in accordance with the Code of Practice for Treasury Management in the Public Services (the Code), issued by the Chartered Institute of Public Finance and Accountancy (CIPFA). Under this Code, the annual Treasury Management Strategy, including the Investment Strategy, is considered and approved by a full meeting of Nottingham City Council before the beginning of the financial year to which it applies.

The Code also requires a series of Prudential Indicators (PIs) to be set and approved for the forthcoming and following two financial years. These financial indicators are derived from proposed treasury management activity and provide insight into the financial impact of activities. They are required to be approved before the first financial year to which they apply, by a full meeting of the City Council. Where necessary, any changes to those indicators during the year must also be reported to and approved at a City Council meeting.

2. RECOMMENDATIONS

Audit Committee are asked to consider and comment on the proposed changes to the Prudential Indicators detailed in **Appendix A**.

3. REASONS FOR CONSIDERATION

The Code requires authorities to nominate a body within the organisation to be responsible for scrutiny of treasury management activity. It is considered that the City Council's Audit Committee is the most appropriate body for this function.

In undertaking this function, the Audit Committee holds the responsibility to provide effective scrutiny of treasury management policies and practices. This provides an opportunity for detailed scrutiny and analysis of the Treasury Management and Investment Strategy by those charged with governance.

4. BACKGROUND

The existing Prudential Indicators were approved by City Council on 7 March 2011 and cover financial years 2011/12 to 2013/14. These are now required to be changed as a consequence of proposed additional prudential borrowing in 2011/12 to finance new capital schemes, in particular for Phase 2 of the Nottingham Express Transit (NET) tram scheme.

The financing of NET Phase 2 is complex, with funding being provided from a number of sources, including Private Finance Initiative grant, existing earmarked reserves, prudential borrowing and an annual income stream from the introduction of a Workplace Parking Levy in Nottingham from 1 April 2012. It is currently proposed that prudential borrowing of up to £436m will be raised in the next 4 years to finance the termination of the existing concessionaire contract for Line One and land acquisitions and other capital costs associated with Phase 2.

The existing Prudential Indicators need to be amended to reflect the above borrowing. In addition, the indicators have been updated to take into account:

- The final out-turn position at 31 March 2011.
- The addition of HRA capital expenditure in respect of the Decent Homes Standard, for which confirmation of central Government-supported borrowing has now been received.
- Amendments to the notional debt figures in respect of on-balance sheet Private Finance Initiative schemes and finance leases.
- Changes to the Authorised and Operational Debt limits, to allow for the 'externalisation' of debt, currently being met internally from cash surpluses.

Appendix 1 provides details of the impact of all the above changes. For 2011/12 the current indicators and the impact of the proposed changes have also been shown.

5. BACKGROUND PAPERS OTHER THAN PUBLISHED WORKS OR THOSE DISCLOSING EXEMPT OR CONFIDENTIAL INFORMATION

None

6. PUBLISHED DOCUMENTS REFERRED TO IN COMPILING THIS REPORT

Treasury Management in the Public Services, Code of Practice 2009 - CIPFA
The Prudential Code for Capital Finance in Local Authorities 2009 – CIPFA
Guidance on Local Government Investments 2009 – Communities & Local Government

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PRUDENTIAL INDICATORS 2011/12 – 2013/14					
	2011/12 Prev.Est £m	2011/12 Rev. Est £m	2011/12 Change £m	2012/13 Rev. Est £m	2013/14 Rev. Est £m
1. PRUDENCE INDICATORS					
i) Capital Expenditure					
General Fund	103.256	454.090	+350.834	77.901	47.457
HRA	25.332	55.300	+29.968	45.879	13.213
	128.588	**509.390**	**+380.802**	**123.780**	**60.670**
ii) CFR at 31 March					
General Fund	312.790	608.192	+295.402	623.223	628.349
HRA	321.075	341.683	+20.608	362.531	361.829
PFI and finance lease debt	259.196	233.776	-25.420	257.684	263.434
	893.061	**1,183.651**	**+290.590**	**1,243.438**	**1,253.612**
iii) External Debt at 31 March					
Borrowing	542.046	890.888	+348.842	926.767	931.191
Other (PFI debt)	259.196	233.776	-25.420	257.684	263.434
	801.242	**1,124.664**	**+323.422**	**1,184.451**	**1,194.625**
2. AFFORDABILITY INDICATORS					
i) Financing costs ratio					
General Fund	8.95%	8.95%	-	9.33%	9.57%
HRA	12.18%	12.18%	-	12.14%	12.19%
ii) Impact of capital investment decisions					
Council Tax Band D (per annum)	£0.00	£0.00	-	£0.00	£0.00
HRA rent (per week)	£0.00	£0.00	-	£0.00	£0.00
	£m	**£m**	**£m**	**£m**	**£m**
iii) Authorised limit for external debt	831.242	1,263.864	+432.622	1,303.651	1,313.825
iv) Operational Boundary for external debt	821.242	1,218.864	+397.622	1,278.651	1,288,825
3. TREASURY MANAGEMENT INDICATORS					
i) Limit on variable interest rates	0-50%	0-50%	-	0-50%	0-50%
ii) Limit on fixed interest rates	50-100%	50-100%		50-100%	50-100%
iii) Fixed Debt maturity structure					
- under 12 months	0-20%	0-20%	-	0-20%	0-20%
- 12 months to 2 years	0-20%	0-20%	-	0-20%	0-20%
- 2 to 5 years	0-25%	0-25%	-	0-25%	0-25%
- 5 to 10 years	0-25%	0-25%	-	0-25%	0-25%
- 10 to 25 years	0-50%	0-50%	-	0-50%	0-50%
- 25 to 40 years	0-25%	0-25%	-	0-25%	0-25%
- 40 years and above	0-75%	0-75%	-	0-75%	0-75%
iv) Sums invested for >364 days					
- in-house limit	£60m	£60m	-	£60m	£60m
v) Adoption of the *CIPFA Code of Practice*	Yes	Yes	Yes	Yes	Yes

See overleaf for notes to the above table.

NOTES TO THE SCHEDULE OF PRUDENTIAL INDICATORS

1) **Prudence Indicators**

i) *'Estimate of total capital expenditure'* – a "reasonable" estimate of total capital expenditure to be incurred in the next 3 financial years, split between the General Fund and the Housing Revenue Account (HRA).

- This estimate takes into account the City Council's asset management and capital investment strategies.

ii) *'Capital financing requirement' (CFR)* – this figure constitutes the aggregate amount of capital spending which has not yet been financed by capital receipts, capital grants or contributions from revenue, and represents the City Council's underlying need to borrow money long-term. An actual figure at 31 March each year is required, together with estimates for the next three financial years.

- This approximates to the previous Credit Ceiling calculation and provides an indication of the total long-term debt requirement.
- From 31 March 2010, the CFR includes an estimation of the total debt which will be brought 'on-balance sheet' in respect of PFI schemes previously not accounted for.

iii) *'External debt'* - the actual level of gross borrowing (plus other long-term liabilities) calculated from the balance sheet, with estimates for the next three financial years. (From 31 March 2010, the figures include the debt relating to on-balance sheet PFI schemes).

2) **Affordability Indicators**

i) '*Ratio of financing costs to net revenue stream'* – expresses the revenue costs of the City Council's borrowing (interest payments and provision for repayment) as a percentage of the total sum to be raised from government grant, business rates and council tax (General Fund) and housing subsidy and rent income (HRA).

- These indicators show the impact of borrowing on the City Council's revenue accounts and enable a comparison between years to be made. At present, the cost of borrowing is supported by Central Government through the Revenue Support Grant and Housing Subsidy systems, although this may not always be the case in the future.

ii) *'Incremental impact of capital investment decisions'* – expresses the revenue consequences of future capital spending plans to be met from unsupported borrowing on both the level of council tax and weekly housing rents.

- This is a key indicator, which provides a direct link between the City Council's capital programme and its revenue budget and enables the revenue impact of additional unsupported capital investment to be understood.

iii) *'Authorised limit for external debt'* – this represents the maximum amount that the City Council may borrow at any point during the year and replaces the previous 'overall external borrowing' limit. An estimate for the next three financial years is required.

- This figure allows for the possibility that all borrowing for capital purposes may be undertaken early in the year, with a further sum to reflect any temporary borrowing as a result of adverse cash flow. This represents a 'worst case' scenario and the level is very unlikely to be reached.

iv) *'Operating boundary for external debt'* – this indicator is a working limit and represents the highest level of borrowing that the City Council is expecting to reach at any time during the year

- It is recognised that this operational boundary may be breached in exceptional circumstances. However, the Prudential Code recommends that a sustained pattern of borrowing above this limit be investigated as a potential symptom of a more serious financial problem.

3) **Treasury Management Indicators**

i) *'The amount of net borrowing which is at a variable rate of interest'* - expressed either as an absolute amount or a percentage. Upper and lower limits for the next three financial years are required.

- High levels of variable rate debt leaves the City Council at risk from increases in interest rates. This figure represents the maximum permitted exposure to such debt.

ii) *'The amount of net borrowing which is at fixed rate of interest'* - expressed either as an absolute amount or a percentage. Upper and lower limits for the next three financial years are required.

- Fixed rate borrowing provides certainty for future interest costs, regardless of movements in interest rates. The lower limit is effectively the counterpart to the upper limit for variable rate borrowing.

iii) *'Upper and lower limits with respect to the maturity structure of the authority's borrowing'* – this shows the amount of fixed rate borrowing maturing in each period, expressed as a percentage of total fixed rate borrowing.

- This indicator is designed to be a control over the City Council having large amounts of fixed rate debt falling to be replaced at the same time.

iv) *'Total sums invested for periods of greater than 364 days* – a limit on investments for periods longer than 1 year. A three-year estimate is required.

- This indicator is designed to protect the liquidity of investments, ensuring that large proportions of the City Council's cash reserves are not invested for long periods.

v) *The adoption of the CIPFA Code of Practice for Treasury Management in the Public Services'.* This is not a numerical indicator, but a statement of good practice.

- Nottingham City Council adopted the Code on 18 February 2002. The revised Code, issued in 2009, has been incorporated within the City Council's adopted strategy and procedures.