report

meeting	**NOTTINGHAMSHIRE AND CITY OF NOTTINGHAM FIRE & RESCUE AUTHORITY**
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JOINT REPORT OF THE CHIEF FIRE OFFICER AND TREASURER

PRUDENTIAL CODE FOR CAPITAL ACCOUNTING

1 PURPOSE OF REPORT

The purpose of this report is to inform Members of the Fire Authority of the Authority's obligations under the CIPFA Prudential Code. It also seeks the approval of the Fire Authority to the proposed capital plans, prudential limits, and monitoring processes set out below.

2 BACKGROUND

2.1 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. Members will be aware that the Act changed the way in which Capital Expenditure is controlled within local government and that the Authority has been operating under the prudential regime since April 2004.

2.2 The principles under which local authorities now operate offer much more freedom in the way that capital expenditure is financed such that local authorities may choose the level of capital expenditure (and thus financing) which best suits their needs and investment priorities.

2.3 In order to assist authorities in determining the most appropriate levels of spending and indebtedness the Chartered Institute of Public Finance and Accountancy (CIPFA) has developed a "Prudential Code" which requires a number of limits and indicators to be set.

2.4 This report sets out the proposed prudential limits for the Authority for the 2006/07 financial year along with the implications of the proposed Capital Programme, which is presented with the main budget papers.

3 CURRENT POSITION WITH REGARD TO CAPITAL

3.1 In order to fully understand the implications of the issues set out below it is important to have a view of the current position of the Service with regard to capital and capital financing.

3.2 Nottinghamshire Fire and Rescue Service has a capital asset base for operational purposes which contains mainly property, fire appliances and some IT and communications assets. This is because the restrictions imposed by the old financing regime made the financing of smaller vehicles and most IT related assets impossible, other than by leasing or direct purchase from revenue. Consequently these items do not appear on the Balance Sheet of the Service and are not, therefore, assets of the Service.

3.3 If, however, the method of financing is disregarded, the true working asset base of the Service based on 2004/05 final accounts is:

	£000's
Operational Land & Buildings	23,762
Vehicles	3,223
Plant & Equipment	855
Total Fixed Assets	27,840
Leased Vehicles	619
Leased I.T	621
Leased Other	164
Total Leased "Assets"	1,404
Total All Assets	29,244

3.4 The financing of these assets has been carried out in a number of ways including the use of capital receipts, external borrowing and obligations under finance and operating leases. In terms of external obligations the picture is as follows:

	£000's
Total loans outstanding	2,036
Future finance lease obligations to 2009/10	4,155
Future operating lease obligations to 2009/10	3,426

3.5 The revenue impact of the existing capital base is therefore:

	Leasing £000's	Borrowing £000's
2005/2006	1,415	193
2006/2007	1,701	193
2007/2008	1,552	193
2008/2009	1,506	193
2009/2010	1,407	193

4 PROPOSALS FOR THE 2006/2007 – 2008/2009 CAPITAL PROGRAMME

4.1 It is usual to consider planning for capital expenditure over a period of three years or more and in the budget report Members will note that a three year programme has indeed been prepared.

4.2 In the past Government has set Basic Credit Approvals for authorities which limited the amount of capital expenditure. There are now no such limits however Government does set a level of Supported Capital Expenditure (SCE) within the Resource Needs Formula (RNF) allocated to authorities. This is nothing more than the amount of capital expenditure which Government support via the RNF formula. For the Fire Authority this amount is £948,000 for 2006/07.

4.3 The profile of Capital Expenditure including actuals for 2004/05 and estimates for 2005/06 to 2008/09 is as follows :

CAPITAL EXPENDITURE					
	2004/05 Actual £000's	2005/06 Estimate £000's	2006/07 Estimate £000's	2007/08 Estimate £000's	2008/09 Estimate £000's
Transport	78	294	2,085	1,410	1,810
Property	306	1,307	3,075	725	1,125
I.T. & Communications	489	704	1538	447	330
Total	873	2,305	6,698	2,582	3,265

4.4 The Capital Financing Requirement is the sum of money required from external sources to fund Capital Expenditure. It will therefore be the aggregate of all capital expenditure, less any revenue contributions or capital receipts. It is also important to note that the actual requirements for capital financing will depend to some extent upon the timing of the cashflows of the capital expenditure itself. Estimates of the end of year capital financing requirement for the Authority for the current and future years and the actual capital financing requirement at 31 March 2005 are:

CAPITAL FINANCING REQUIREMENT					
	31/3/05 Actual £000's	31/3/06 Estimate £000's	31/3/07 Estimate £000's	31/3/08 Estimate £000's	31/3/09 Estimate £000's
Total	4488	6614	13047	15108	17768

4.5 It is important to note that the above table provides sufficient "headroom" for a proper balance between leasing and borrowing to be considered.

4.6 Decisions relating to financing methods will be taken as part of an options analysis which will consider the best long term options for the Authority. These options need to be assessed at the time of financing as market conditions can affect these decisions markedly.

4.7 It is also important to note that the figure of £6.614m, showing as the estimated financing requirement for 2005/06, has already been financed within existing revenue budgets.

4.8 Therefore in 2006/07 the Authority will be required to finance £13.047m of capital expenditure (£6.614m already financed as explained above). This financing will be carried out over a number of different periods and different sources may be used. Nevertheless it is possible to estimate the ratio of financing costs to the net revenue stream of the Authority. These estimates assume that the Revenue Budget and the Capital Programme of the Authority, for 2006/07 and subsequent years, will be as reported to Members in the Budget elsewhere on this agenda.

RATIO OF FINANCING COSTS TO NET REVENUE STREAM					
	2004/05 Actual £000's	2005/06 Estimate £000's	2006/07 Estimate £000's	2007/08 Estimate £000's	2008/09 Estimate £000's
Revenue Cost	439	971	1,347	1,826	2,126
Revenue Budget	38,469	39,776	39,847	42,657	44,897
Ratio	1.1%	2.4%	3.4%	4.3%	4.7%

5 EFFECT ON COUNCIL TAXES

5.1 It is a requirement of the Prudential Code that Members are given an estimate of the effect on council taxes of the proposals that are being made for Capital spending. This is not an easy calculation to carry out other than to make the assumption that the Fire Authority will continue to be spending above RNF and therefore all additional spending will fall directly onto the council tax. If this were the case then the amount of council tax to be raised to fund capital spending would be :

EFFECT ON COUNCIL TAXES AT BAND D			
	2006/07 Estimate £000's	2007/08 Estimate £000's	2008/09 Estimate £000's
Revenue Cost	214	200	166
Council Taxbase	322,034	322,034	322,034
Council Tax at Band D	£0.66	£0.62	£0.52

6 PRUDENTIAL LIMITS

6.1 Under the Prudential Code, the Authority is required to set prudential limits for the amount of indebtedness it can reasonably sustain. These limits are called the **Authorised Limit** and the **Operational Boundary.**

- The **Operational Boundary** is the Authority's estimate of its total outstanding debt, gross of investments and other long-term liabilities. 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.

- The **Authorised Limit** is essentially the same but allows headroom over and above the operational boundary to take account of such 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.

6.2 A variation from the operational boundary is permissible, but reportable, whereas any proposed variation from the authorised limit must be authorised by the Fire Authority.

6.3 These limits need to be set including both long term external borrowing and also short term borrowing in respect of overdrafts.

6.4 Cash flow forecasts have been prepared for 2006/07 to 2008/09 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. This is the same figure that was used for 2005/06.

6.5 Whilst not in the Capital Programme as an additional item it is likely that the Authority will be involved in a contract for the acquisition of land and carrying out building works in connection with the proposed Beeston/Dunkirk merger and relocation. The timing of cash flows will require some additional short term borrowing until the Dunkirk site can be marketed. Additional borrowing ceiling is therefore sought for £3,500,000 to enable this to take place.

6.6 It is therefore proposed that the Authority should set the following authorised limits and operational boundaries for the year 2006/07, 2007/08 and 2008/09:

PRUDENTIAL LIMITS			
Year	**2006/07**	**2007/08**	**2008/09**
Authorised Limit	15,117	14,108	17,699
Operational Limit	13,743	12,825	16,090

7 TREASURY MANAGEMENT

7.1 In Nottinghamshire the Fire Authority has always carried out its own treasury management in accordance with CIPFA guidelines. Whilst the sums involved are relatively small it is nevertheless important to ensure that the Authority's best interests are protected.

7.2 The Authority has an approved a list of institutions that it is prepared to lend to, and these constitute those with only the highest credit ratings. This policy is to continue.

7.3 In terms of borrowing, it has always been considered prudent to use Public Works Loans Board (PWLB) Fixed Interest Loans. This is because the PWLB offers rates which cannot be obtained anywhere else in the marketplace. This practice will be kept under continuous review to take account of any relevant changes in the marketplace.

8 INTEREST RATE RISK EXPOSURE

8.1 Whilst the PWLB has fairly strict rules for borrowing, the Authority meets all of their requirements and therefore it is proposed to continue with this strategy. As to the issue of fixed vs. variable rate decisions it would not be prudent to rule out variable rates absolutely, and therefore it is 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. The assumptions used throughout this report are that fixed interest rates are likely to remain steady for most of the year but then rise by up to 0.25% by the end of 2006/07 and that investment rates are likely to fall by up to 0.5% by the end of the same period.

8.2 The total value of lending is not expected to exceed £4,000,000 at its peak during 2006/07 however it is difficult to assess what the likely investment profile might be. At this stage it is unlikely that the Authority will engage in investment for any period longer than 12 months. Current investments are all short term and at rates fixed for short periods.

8.3 It is proposed therefore that the Authority sets the following limits for interest rate exposures for 2006/07, 2007/08 and 2008/09:

INTEREST RATE EXPOSURES			
	2006/07	**2007/08**	**2008/09**
Upper limit for fixed rate exposures	100%	100%	100%
Upper limit for variable rate exposures	30%	30%	30%

8.4 This means that the Head of Finance and Resources will manage fixed rate exposures from a minimum of 70% to a maximum of 100% and variable exposures from a minimum of 0% to an upper limit of 30%.

9 MATURITY OF LOANS

9.1 The majority of existing external loans are for periods of 40 years as they relate to land and buildings. Whilst the code of practice and various CIPFA guidelines state that there should be no direct linkage between the assets financed and the loans taken out it is considered that the life span of the assets purchased must inform this process. It is proposed therefore that upper and lower limits for loan financing should be set as follows:

LOAN MATURITY		
	Upper Limit	**Lower Limit**
Under 12 months	20%	0%
12 months to 5 years	20%	0%
5 years to 10 years	75%	0%
Over 10 years	90%	25%

10 MONITORING OF INDICATORS

It is proposed that prudential indicators should be monitored on a monthly basis by the Head of Resources and Finance and that a report is made to the Fire Authority on a quarterly basis to confirm that these limits are being adhered to.

11 PERSONNEL IMPLICATIONS

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

12 FINANCIAL IMPLICATIONS

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

13 EQUALITY IMPACT ASSESSMENT

The are no issues of equality arising from this report.

14 RISK MANAGEMENT IMPLICATIONS

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

I) The risk of over exposure of the Authority to interest rate fluctuations
II) The risk that the Authority has an unmanageable or unaffordable level of borrowing.

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

15 RECOMMENDATIONS

15.1 That Members note the contents of this report and approve the prudential limits for 2006/07 as follows:

Authorised Limit	£15,117,000
Operational Limit	£13,743,000
Upper limit for variable rate interest exposures	30%
Upper limit for fixed rate interest exposures	100%

Loan Maturity		
Under 12 months		less than 20%
12 months to 5 years		less than 20%
5 years to 10 years		less than 75%
Over 10 years	Greater than 25%	less than 90%

16 BACKGROUND PAPERS FOR INSPECTION

None.

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