report

meeting	**NOTTINGHAMSHIRE AND CITY OF NOTTINGHAM FIRE & RESCUE AUTHORITY**	
date	**23 February 2007**	agenda item number

JOINT REPORT OF THE CHIEF FIRE OFFICER AND THE TREASURER OF THE FIRE & RESCUE AUTHORITY

PRUDENTIAL CODE FOR CAPITAL FINANCE

1. PURPOSE OF REPORT

The purpose of this report is to inform Members of the Authority's obligations under the CIPFA Prudential Code. It also seeks the approval of Members 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. The Act changed the way in which Capital Expenditure is controlled within local government and 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. The objective of these indicators is to ensure that capital expenditure plans are affordable; that external borrowing and long term liabilities are within prudent and sustainable levels and that treasury management is carried out in accordance with good professional practice.

2.4 This report sets out the proposed prudential limits for the Authority for the 2007/08 financial year along with the implications of the proposed Capital Programme, which will be presented with the budget report.

3. REPORT

CAPITAL EXPENDITURE AND BORROWING

3.1 Estimates of Capital Expenditure Future Years and Actual Capital Expenditure 2005/06

2005/06 Actual £000's	2006/07 Estimate £000's	2007/08 Estimate £000's	2008/09 Estimate £000's	2009/10 Estimate £000's
Capital Expenditure Total				
1,572	4,549	8,417	2,349	2,307
Capital Expenditure – Financed by Borrowing / Finance Lease				
1,412	2,630	6,819	1,622	1,828
Capital Expenditure – Financed by Revenue				
160	1,919	1,598	727	479

The estimates for 2007/08 to 2009/10 will be submitted to the Fire Authority for approval on 23 February 2007. 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.

3.2 Estimates of Capital Financing Requirement Future Years and Actual Capital Financing Requirement 2005/06

2005/06 Actual £000's	2006/07 Estimate £000's	2007/08 Estimate £000's	2008/09 Estimate £000's	2009/10 Estimate £000's
Capital Financing Requirement				
6,837	11,113	19,085	20,671	22,151

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 cash flows of the capital expenditure itself.

3.3 Estimates of Ratio of Financing Costs to Net Revenue Stream Future Years and Actual 2005/06

2005/06 Actual £000's	2006/07 Estimate £000's	2007/08 Estimate £000's	2008/09 Estimate £000's	2009/10 Estimate £000's
Ratio of Financing Costs to Net Revenue Stream				
2.0%	2.1%	4.1%	5.7%	5.8%

3.4 Estimates of Incremental Impact on Council Tax (Band D) Future Years

2007/08 Estimate £000's	2008/09 Estimate £000's	2009/10 Estimate £000's
Incremental Impact on Council Tax		
£2.66	£2.41	£0.37

3.5 Operational Boundary and Authorised Limit for External Borrowing

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. A variation from the operational boundary is permissible, but must be reported to the Fire Authority.

3.6 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

3.7 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.

3.8 It is likely that the Authority will be paying for the construction of the new fire station at Hassocks Lane before the Dunkirk fire station site can be sold. The timing of cash flows will require some additional short term borrowing in the interim period. The additional borrowing ceiling required has therefore been included in both the Operational Boundary and the Authorised Limit.

	2007/08 £000's	2008/09 £000's	2009/10 £000's
Prudential Limits			
Operational Boundary	17,853	15,975	17,803
Authorised Limit	19,638	17,573	19,583

3.9 Actual External Debt

The Authority's external borrowing as at 31 March 2006 was £3.807m

3.10 TREASURY MANAGEMENT

In Nottinghamshire the Fire Authority carries out its own treasury management in accordance with the CIPFA Code of Practice for Treasury Management. Whilst the sums involved are relatively small it is nevertheless important to ensure that the Authority's best interests are protected. 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. In terms of borrowing, it has always been considered prudent to use Public Works Loans Board (PWLB) Fixed Interest Loans. This is because on the basis of past performance the PWLB generally 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.

3.11 Interest Rate Risk Exposure

Whilst the PWLB has fairly strict rules for borrowing, the Authority meets all of its requirements and therefore it is proposed to continue with this strategy. As to the issue of fixed versus 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. It is expected that borrowing rates may rise at the end of 2006/07 but then remain steady throughout 2007/08 and that investment rates are likely to remain steady during the same period.

The total value of lending is not expected to exceed £4,000,000 at its peak during 2007/08 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.

It is proposed therefore that the Authority sets the following limits for interest rate exposures for 2007/08, 2008/09 and 2009/10:

	2007/08 £000's	2008/09 £000's	2009/10 £000's
Interest Rate Exposures			
Upper Limit for fixed rate exposures	100%	100%	100%
Upper Limit for variable rate exposures	30%	30%	30%

3.12 Loan Maturity

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. The upper limit for loans with a term of more than 10 years has previously been set at 90% however the yield curve for fixed interest securities is currently displaying lower borrowing rates for longer term loans. It is therefore proposed that the upper limit for loans over 10 years is revised to 100% to enable the Authority to take advantage of this situation should it continue into 2007/08. It is proposed 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	100%	25%

Prudential Limit for Principal Sums Invested for Periods Longer than 364 Days

There are no proposals for the Authority to invest for periods longer than 364 days.

3.13 MONITORING OF PRUDENTIAL INDICATORS

Performance against the indicators for 2007/08 will be reported quarterly to Finance and Resources Committee.

4. RISK MANAGEMENT IMPLICATIONS

The risk exposures in this report relate primarily to two 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.

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

5. FINANCIAL IMPLICATIONS

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

6. PERSONNEL IMPLICATIONS

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

7. EQUALITY IMPACT ASSESSMENT

An initial equality impact assessment on the Prudential Code has been carried out and no impacts were identified.

8. RECOMMENDATIONS

That Members note the contents of this report and approve the prudential limits for 2007/08 as follows :

Authorised Limit		£19,638,000
Operational Boundary		£17,853,000
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 100%

9. BACKGROUND PAPERS FOR INSPECTION

None

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