NOTTINGHAMSHIRE
Fire & Rescue Service
Creating Safer Communities

Nottinghamshire and City of Nottingham
Fire and Rescue Authority

PRUDENTIAL CODE FOR CAPITAL FINANCE 2009/10

Joint report of the Treasurer and Chief Fire Officer

Agenda Item No:	
Date:	**20 February 2009**

Purpose of Report:

To inform Members of the Authority's obligations under the Chartered Institute of Public Finance and Accountancy (CIPFA) Prudential Code. 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. 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.

1.2 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.

1.3 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.

1.4 This report sets out the proposed prudential limits for the Authority for the 2009/10 financial year along with the implications of the proposed Capital Programme, which will be presented with the budget report.

2. REPORT

CAPITAL EXPENDITURE AND BORROWING

2.1 <u>Estimates of Capital Expenditure Future Years and Actual Capital Expenditure 2007/08</u>

2007/08 Actual £000's	2008/09 Estimate £000's	2009/10 Estimate £000's	2010/11 Estimate £000's	2011/12 Estimate £000's
Capital Expenditure Total				
4,531	7,049	5,545	4,900	2,766
Capital Expenditure – Financed by Borrowing / Finance Lease				
4,461	7,049	5,545	4,900	2,766
Capital Expenditure – Financed by Revenue				
70	0	0	0	0

The estimates for 2009/10 to 2011/12 are submitted to the Fire Authority for approval elsewhere on this agenda. 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.

2.2 Estimates of Capital Financing Requirement Future Years and Actual Capital Financing Requirement 2007/08

2007/08 Actual £000's	2008/09 Estimate £000's	2009/10 Estimate £000's	2010/11 Estimate £000's	2011/12 Estimate £000's
Capital Financing Requirement				
14,858	22,554	27,419	30,677	31,511

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.

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 capital financing requirement in future years should not exceed £40m

2.3 Estimates of Ratio of Financing Costs to Net Revenue Stream Future Years and Actual 2007/08

2007/08 Actual £000's	2008/09 Estimate £000's	2009/10 Estimate £000's	2010/11 Estimate £000's	2011/12 Estimate £000's
Ratio of Financing Costs to Net Revenue Stream				
2.7%	3.5%	5.1%	6.4%	7.3%

The Sustainable Capital Plans report referred to in paragraph 2.2 also concluded that the revenue impact of borrowing should be contained within 8% of the total revenue budget.

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

2009/10 Estimate £000's	2010/11 Estimate £000's	2011/12 Estimate £000's

Incremental Impact on Council Tax		
£2.42	£2.25	£1.50

Operational Boundary and Authorised Limit for External Borrowing

2.5 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.

2.6 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

2.7 Cash flow forecasts have been prepared for 2008/09 to 2010/11 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.

	2009/10 £000's	2010/11 £000's	2011/12 £000's
Prudential Limits			
Operational Boundary	25,492	30,392	33,158
Authorised Limit	28,041	33,431	36,474

2.8 Actual External Debt

The Authority's external borrowing as at 31 March 2008 was £9.776m and in November 2008, further borrowing of £7.0m was taken.

2.9 Monitoring of Prudential Indicators

Performance against the indicators for 2009/10 will be reported quarterly to Finance and Resources Committee.

TREASURY MANAGEMENT

2.10 The Service 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 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.

2.11 Members will be aware that the past year has seen turmoil in the global financial markets and that the UK economy, along with many others, is in recession. The Authority has reacted to events such as falling credit ratings, banks at risk of failure and falling interest rates. A more detailed Treasury Management Strategy 2009/10 report will be submitted to Finance and Resources Committee on 27 March 2009, but the paragraphs below summarise the key issues in this area.

2.12 Credit Risk

The Authority has an approved a list of institutions that it is prepared to lend to, and the list constitutes those with high credit ratings. Our treasury management advisers, Sector, notify the Authority of any changes to credit ratings on a daily basis and institutions who no longer meet the minimum criteria are removed from the list immediately. Although the list includes overseas institutions, the Authority is currently only investing surplus funds with UK institutions. This arrangement was put in place with the agreement of the Treasurer and Members to protect the security of funds. This policy will continue until such time as it is felt that the wider list can be safely used.

Interest Rate Risk Exposure

2.13 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.

2.14 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. With the recent cuts in the bank rate, both borrowing and investment rates have fallen and are currently relatively low. Borrowing rates in 2009/10 are expected to remain fairly steady but it should be noted that unusual money market conditions are prevailing and that assumptions may well change.

2.15 The total value of lending is not expected to exceed £6,000,000 at its peak during 2009/10 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 for less than 1 year and at rates fixed for short periods. If borrowing is taken out during the year as a single transaction, then the aim will be to reduce risk by investing funds in more than one institution. Members should note, however, that it is not feasible to set a maximum limit for investing with any one institution as the numbers of UK banks and building societies 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". It is more likely that borrowing will be taken in smaller blocks during the year, to reduce any risks associated with investing in the prevailing market conditions.

2.16 It is proposed that the Authority sets the following limits for interest rate exposures for 2009/10, 2010/11 and 2011/12:

	2008/09 £000's	2009/10 £000's	2010/11 £000's
Interest Rate Exposures			
Upper Limit for fixed rate exposures	100%	100%	100%
Upper Limit for variable rate exposures	30%	30%	30%

2.17 <u>Loan Maturity</u>

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. It is felt, however, that the 20% upper limit in respect of 12 months to 5 year loans is overly restrictive. It is proposed that this limit is increased to 30% but that the remaining upper and lower limits continue to apply.

Loan Maturity		
	Upper Limit	Lower Limit
Under 12 months	20%	0%

12 months to 5 years	30%	0%
5 years to 10 years	75%	0%
Over 10 years	100%	25%

2.18 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. 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. EQUALITY IMPACT ASSESSMENT

There are no specific equality impacts which arise directly from this report.

6. CRIME AND DISORDER IMPLICATIONS

There are no specific crime and disorder implications which arise directly from this report.

7. LEGAL IMPLICATIONS

There are no legal implications which arise directly from this report.

8. 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.

9. RECOMMENDATIONS

That Members approve the Prudential Limits for 2009/10 as follows:

Authorised Limit	£28,041,000
Operational Boundary	£25,492,000
Upper limit for variable rate interest exposures	30%
Upper limit for fixed rate interest exposures	100%
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 25%

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

None.

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TREASURER TO THE FIRE AUTHORITY