NOTTINGHAMSHIRE
Fire & Rescue Service
Creating Safer Communities

Nottinghamshire and City of Nottingham
Fire and Rescue Authority

PRUDENTIAL CODE FOR CAPITAL FINANCE 2012/13

Joint Report of the Treasurer and Chief Fire Officer

Agenda Item No:

Date: 24 February 2012

Purpose of Report:

To inform Members of the 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 2009.

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 2009) 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 2012/13 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 <u>Estimates of the Ratio of Financing Costs to Net Revenue Stream for 2011/12, 2012/13, 2013/14 and 2014/15 and Actual Ratio of Financing Costs for 2010/11</u>

2010/11 Actual £000's	2011/12 Estimate £000's	2012/13 Estimate £000's	2013/14 Estimate £000's	2014/15 Estimate £000's
Ratio of Financing Costs to Net Revenue Stream				
5.9%	6.3%	7.7%	5.4%	5.3%

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 in 2012/13, the ratio is expected to increase to a level which is close to the 8%, but the application of reserves to finance capital, which is proposed in the budget, brings the ratio back down to an affordable level in the following years.

2.2 Estimates of the Incremental Impact of the New Capital Investment Decisions on the Council Tax (Band D) for 2012/13, 2013/14 and 2014/15

2012/13 Estimate £000's	2013/14 Estimate £000's	2014/15 Estimate £000's
Incremental Impact on Council Tax		
+£1.96	-£3.59	-£0.24

The table above shows that the effect of financing capital expenditure from reserves in 2011/12, 2012/13 and 2013/14 is a reduction in the incremental impact on council tax.

PRUDENTIAL INDICATORS FOR PRUDENCE

2.3 Net Borrowing and the Capital Financing Requirement

This indicator requires that net external borrowing does not, except in the short term, exceed the total of the capital financing requirement estimated up to the end of 2014/15. Performance against this indicator will be monitored throughout the year. At 31 March 2011, the Capital Financing Requirement was £28,953k and Net Borrowing (total borrowing less investments) was £20,652

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 2011/12, 2012/13, 2013/14 and 2014/15 and Actual Capital Expenditure for 2010/11

2010/11 Actual £000's	2011/12 Estimate £000's	2012/13 Estimate £000's	2013/14 Estimate £000's	2014/15 Estimate £000's
Capital Expenditure Total				
6,766	3,935	3,722	4,949	3,934
Capital Expenditure – Financed by Borrowing / Finance Lease				
984	0	16	0	300
Capital Expenditure – Financed by Revenue Contributions				
2,608	2,449	2,200	2,000	0
Capital Expenditure – Financed by Internal Funds				
1,362	0	20	1,949	3,134
Capital Expenditure – Financed by Capital Grant				
946	1,486	1,486	1,000	500
Capital Expenditure – Financed by Donation				
866	0	0	0	0
Capital Expenditure – Financed by Capital Receipt				
0	0	0	0	0

The estimates for 2012/13 to 2014/15 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. The table above assumes that in 2012/13 and 2013/14 a total of £4,200k 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 2011/12, 2012/13, 2013/14 and 2014/15 and Actual Capital Financing Requirement as at 31/03/11

2010/11 Actual £000's	2011/12 Estimate £000's	2012/13 Estimate £000's	2013/14 Estimate £000's	2014/15 Estimate £000's
Capital Financing Requirement				
28,953	27,241	24,922	24,106	26,299

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 2011/12 and 2013/14 mainly due to the effect of revenue financing. It should be emphasised that the Capital Financing Requirement relates to all capital financing of both existing capital and new capital spend. The figure in 2012/2013 therefore represents a reduction in overall indebtedness compared with 2011/2012.

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 2012/13 to 2014/15 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.

	2012/13 £000's	2013/14 £000's	2014/15 £000's
Operational Boundary			
O.B. for borrowing	28,100	28,100	30,400
O.B. for other long term liabilities	664	638	612
Total - Operational Boundary for External Debt	28,764	28,738	31,012
Authorised Limit			
A.L. for borrowing	30,910	30,910	33,440
A.L. for other long term liabilities	731	702	674
Total - Authorised Limit for External Debt	31,641	31,612	34,114

2.10 Actual External Debt as at 31/03/11

	2010/11 £000's
Actual borrowing	27,707
Actual other long term liabilities	721
Total – Actual External Debt	28,428

This debt supports an overall asset base of £50.454m valued at 31st March 2011.

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 2009. 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 debt as at 31/03/11 was £27,707k, as reported in paragraph 2.10. In addition, short term debt as at the same date totalled £721k. At the same date, the amount of investments was £7,055k, giving a net debt position of £21,373k as at 31/03/11.

2.13 The Treasury Management Strategy 2012/13 report, which is elsewhere on this agenda, outlines the proposal to use the Authority's surplus balances to partially finance new capital expenditure by way of revenue contributions and also to make additional voluntary minimum revenue provision. The impact of this will be to reduce ongoing revenue costs in future years. There will still be a need to borrow over the next three years, and the decision about when to borrow and when to use revenue contributions to fund the capital programme 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 £15m, which is likely to peak around July 2012 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. Current investments are all for less than 3 months, in line with the latest guidance from Sector, and at rates fixed for short periods. 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. It is expected that the total amount invested will reduce as the year progresses and capital expenditure is funded by revenue contributions.

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

	Benchmark %	2011/12 £000's	2012/13 £000's	2013/14 £000's	2015/16 £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. Members will be aware that the Authority has been in breach of the lower limit of 20% for loans maturing in the 10 to 20 years band throughout 2011/12 and that it will not be possible to rectify this breach until further borrowing takes place and loans are taken which mature within these dates.

2.19 As further borrowings are not required to finance capital expenditure in 2012/13, it is proposed that the prudential limits are amended. The purpose of the lower limit in the 10 to 20 year and in the over 20 year bands is to ensure that the Authority has a reasonable balance of longer term loans and is therefore not unduly exposed to interest rate risk arising from the renewal of loans. It is recommended that the lower limit in the 10 to 20 year band is reduced to 0%, which will eliminate the current breach, and that the lower limit in the over 20 year band is maintained at 30% to ensure that overall there is still at least 30% of borrowings maturing in more than 10 years' time. Projections of principal repayments for currently held loans show that by March 2014, the total proportion of loans with a repayment profile of above 20 years will rise back to almost 40% again as shorter term loans will have matured. When borrowing does take place, it should be for a longer term than 15 years to protect the Authority from interest rate risk.

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.

2012/13 £000's	2013/14 £000's	2014/15 £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. PERSONNEL IMPLICATIONS

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

5. EQUALITIES IMPLICATIONS

This is not a new policy or service, so no initial assessment has been completed. 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 which arise directly from this report.

7. 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.

8. RECOMMENDATIONS

That Members approve the Prudential Limits for 2012/13 as follows:

Estimate of Ratio of Financing Costs to Net Revenue Stream	7.7%
Estimate of the Incremental Impact of the New Capital Investment Decisions on the Council Tax (Band D)	£1.96
Estimate of Total Capital Expenditure to be Incurred	£3,722,000
Estimate of Capital Financing Requirement	£24,922,000
Operational Boundary	£28,764,000
Authorised Limit	£31,641,000
Upper limit for fixed rate interest exposures	100%
Upper limit for variable rate interest exposures	30%
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 0%
Over 20 years	Upper 100% Lower 30%
Upper Limit for Principal Sums Invested for Periods Longer than 364 Days	£2,000,000

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

None.

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CHIEF FIRE OFFICER

Peter Hurford
TREASURER TO THE FIRE AUTHORITY