

The Prudential Code for Capital Investment in Local Authorities

1. Introduction

- 1.1 There are a number of treasury indicators which previously formed part of the Prudential Code, but which are now more appropriately linked to the CIPFA Code of Practice on Treasury Management, (the Code), and the CIPFA Prudential Code for Capital Finance in Local Authorities, (the Prudential Code). Local authorities are still required to “have regard” to these treasury indicators.
- 1.2 The key treasury indicators which are still part of the Prudential Code are:
- Authorised limit for external debt;
 - Operational boundary for external debt; and
 - Actual external debt.

2. **Net borrowing and the Capital Financing Requirement**

- 2.1 The Council undertakes capital expenditure on long-term assets. These activities may either be:
- Financed immediately through the application of capital or revenue resources (capital receipts, capital grants, revenue contributions etc.), which has no resultant impact on the Council's borrowing need; or
 - If insufficient financing is available, or a decision is taken not to apply resources, the capital expenditure will give rise to a borrowing need;
- 2.2 To ensure that borrowing levels are prudent over the medium term the Council's external borrowing, net of investments, must only be for a capital purpose. This essentially means that the Council is not borrowing to support revenue expenditure.
- 2.3 Net borrowing should not therefore, except in the short term, have exceeded the Capital Financing Requirement (“CFR”) for 2020/21 plus the expected changes to the CFR over 2020/21 from financing the capital programme. This indicator allows the Council some flexibility to borrow in advance of its immediate capital needs in 2020/21.
- 2.4 For a number of years, the Council has used borrowing to fund its Investment and Acquisition Strategy (IAS), which is predominantly focused on the regeneration of the borough and the provision of affordable housing. Prior to any investment a scheme is appraised to ensure that it is financially viable and provides a contribution to the Council that will, at a minimum, cover its interest costs and Minimum Revenue Provision contribution, as well as pay for its management and maintenance costs. The IAS will result in a significant increase in the Council's borrowing, but this will be supported by an asset of a similar value being built and cash flows into the Council to support the increased borrowing.
- 2.5 Once a scheme is agreed and after development starts, treasury will seek to secure the borrowing to fund the scheme at a competitive rate. As such, from time to time, the Council may hold a higher-than-average cash balance as it holds the borrowed amount until it is required for the investment.

- 2.6 Borrowing activity is constrained by prudential indicators for gross borrowing and the CFR, and by the authorised limit.
- 2.7 **The authorised limit** – This sets the maximum level of external borrowing on a gross basis (i.e. Not net of investments) and is the statutory limit determined under Section 3 (1) of the Local Government Act 2003 (referred to in the legislation as Affordable Limit).
- 2.8 **The operational limit** – This links directly to the Council’s estimates of the CFR and estimates of other cash flow requirements. This indicator is based on the same estimates as the Authorised Limits reflecting the most likely prudent but not worst-case scenario but without the additional headroom included within the Authorised Limit for future known capital needs now. It should act as a monitor indicator to ensure the authorised limit is not breached.
- 2.9 **Total external borrowing**, including PFI and Finance Leases as at 31 March 2021 was £1.10bn, which is lower than the Approved Authorised Limit of £1.35bn and lower than the Operational Boundary of £1.25bn.

3. Capital Outturn and Capital Finance Requirement for 2020/21

- 3.1 The capital programme for 2020/21 was £343.5m, taking into account adjustments for the Investment and Acquisition Strategy (IAS) to reflect new schemes being added as and when they are agreed by Cabinet. The equity part of the Muller site purchase has been included as commercial investments. The transformation budget has been adjusted to reflect the actual spend and this has been funded by using capital receipts received during the year.
- 3.2 The 2020/21 gross Capital Spend was £293.8m against a budget of £343.5m, an underspend of £49.7m or 14.5%. with most of the spend in the IAS (£245.3m), Education, Youth and Childcare (£18.8m) and HRA (£26.1m). The impact of Covid is the main reason for the underspend.
- 3.3 The HRA programme is self-financed by the HRA using a mixture of Government grants, capital receipts and HRA revenue funding. Therefore, they do not pose a pressure on the General Fund, in terms servicing the cost of borrowing. The service has spent £26.1m, which equates to 47% of the annual budget in 2020/21.

3.4 The 2020/21 outturn position is detailed below:

Capital Expenditure by Service	2020/21 Outturn	Budget	Over / (Under) spend
	£000	£000	£000
Adults Care & Support	1,449	2,196	(747)
Community Solutions	113	187	(74)
CIL / S106	622	1,720	(1,098)
Core	1,860	4,236	(2,376)
Culture, Heritage & Recreation	623	3,069	(2,446)
Enforcement	389	1,116	(727)
Transport for London	1,000	2,516	(1,516)
My Place	4,145	5,643	(1,498)
Public Realm	924	3,391	(2,467)

Education, Youth & Childcare	18,762	19,572	(810)
Other	700	1,606	(906)
General Fund	30,587	45,252	(14,665)
HRA			
Stock Investment (My Place)	17,428	38,458	(21,030)
New Build Schemes (Be First)	1,064	2,495	(1,431)
Estate Renewal (Be First)	7,645	8,000	(355)
HRA Total	26,137	48,953	(22,816)
Transformation	3,999	3,999	-
IAS			
Residential Developments	153,939	158,327	(4,388)
Temporary Accommodation	10,777	14,022	(3,245)
Commercial Investments	95,078	97,476	(2,398)
Investments Total	259,794	269,825	(10,031)
Add: PFI Additions (lifecycle costs)	144	144	0
Add: New Finance Lease (CF27)	94,600	94,600	0
Approved Capital Programme	415,261	462,773	(47,512)
Financed by:			
Grants	(29,254)		
Section 106	(3,357)		
CIL	(848)		
Capital Receipts	(3,999)		
HRA Contributions	(26,137)		
Sub Total	(63,595)		
Net financing need for the year	351,666		
Prudential Indicator – CFR			
Opening CFR as at 31 March 2020	867,933		
Change in Year – General Fund	291,909		
Change in Year – Housing	0		
Total CFR as at 31 March 2021	1,159,842		
Net movement in CFR	291,909		
Net financing need for the year	351,666		
Less: MRP*	(12,131)		
Less: Capital Receipts	(47,626)		
Movement in CFR	291,909		
Long & Short-Term Borrowing	963,850		
PFI and finance lease liabilities*	217,840		
Total debt 31 March 2021	1,181,690		
Operational Boundary	1,250,000		
Authorised Limit	1,350,000		

* includes draft CR27 figures

4. Affordability Prudential Indicators.

- 4.1 The previous sections cover the overall capital and control of borrowing prudential indicators, but within this framework prudential indicators are required to assess the affordability of the capital investment plans. These provide an indication of the impact of the capital investment plans on the Council's overall finances.
- 4.2 The ratio of financing costs to net revenue stream. This indicator identifies the cost of capital (borrowing and MRP net of investment income) against the net revenue stream. For 2019/20 this was 4.72%, with most of the cost being MRP. The 2019/20 comparator figure has been adjusted to take into account capitalised interest relating to 2019/20 and post audit adjustments. The 2020/21 ratio is 2.81%, with the reduction due to capitalised interest and the good treasury and investment returns.

Table 2: Financing costs to net revenue stream 2019/20 & 2020/21

General Fund Cost of Capital	2019/20 Actual	2020/21 Actual
Net General Fund Base Budget	148,820	155,796
Cost of Capital		
GF Interest Payable	12,374	13,069
Capitalised Interest	(1,522)	(3,002)
Treasury Income	(8,818)	(8,817)
Investment Income	(2,735)	(6,230)
MRP	7,731	9,352
Net Cost of Capital	7,030	4,372
Financing Cost to Net Revenue	4.72%	2.81%

5. Limits for Fixed and Variable Interest Exposure

- 5.1 The following prudential indicators allow the Council to manage the extent to which it is exposed to changes in interest rates. The upper limit for variable rate exposure has been set to ensure that the Council is not exposed to interest rate rises which could adversely impact on the revenue budget.
- 5.2 The Council's existing level of fixed interest rate exposure is 100.0% and variable rate exposure is 0.0%. The high fixed interest rate is as a result of locking in low long-term rates for the HRA borrowing and for the IAS, which requires certainty over the cost of borrowing. Table 3 shows the fixed and variable interest rate exposure.

Table 3: Fixed and variable rate exposure 2019/20 to 2021/22

Interest Rate Exposures	2020/21	2021/22	2022/23
	Actual	Estimate	Estimate
Upper limit for fixed interest rate exposure	100.0%	100.0%	100.0%
Upper limit for variable interest rate exposure	70.0%	70.0%	70.0%

6. Maturity Structure of Fixed Rate Borrowing

This prudential indicator deals with projected borrowing over the period and the rates that they will mature over the period. The majority of General Fund borrowing is either equal instalment repayment or annuity repayment, which means that each year a part of the loan is repaid. Table 4 summarises the borrowing structure based on £963.8 of long and short-term borrowing.

Table 4: Borrowing as at 31 March 2021

Maturity structure of fixed interest rate borrowing 2020/21			
	Actual Position	Lower	Upper
Under 12 months	8.62%	0%	40%
12 months to 2 years	2.22%	0%	60%
2 years to 5 years	6.65%	0%	70%
5 years to 10 years	13.15%	0%	70%
10 years and above	69.36%	0%	100%

Investments over 364 days

- 7.1 The overriding objective of the investment strategy is to ensure that funds are available on a daily basis to meet the Council's liabilities. Taking into account the current level of investments, and future projections of capital expenditure, the following limits will be applied to sums invested:

	2020/21	2021/22	2022/23
	£000's	£000's	£000's
Maximum principal sums invested > 364 days £'000s	Actual	Estimate	Estimate
Principal sums invested > 364 days	450,000	350,000	300,000

8.1 Summary Assessment

- 8.1 The outturn position is set out above in respect of the Prudential Indicators approved by Assembly in February 2020.
- 8.2 The outturn figures confirm that the limits and controls set for 2020/21 were applied throughout the year, and that the treasury management function adhered to the key principles of the CIPFA Prudential Code of prudence, affordability and sustainability. The treasury management indicators were regularly monitored throughout 2020/21.