

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 2021/22 plus the expected changes to the CFR over 2021/22 from financing the capital programme. This indicator allows the Council some flexibility to borrow in advance of its immediate capital needs in 2021/22.

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 (MRP) 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. It also means that decisions made on future schemes may have different borrowing rate assumptions, depending on borrowing rates at the time.
- 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 at 31 March 2022 was £1.35bn, which is lower than the Approved Authorised Limit of £1.8bn and Operational Boundary of £1.7bn. During 2021/22 there were no breaches of these limits.

3. Capital Outturn and Capital Finance Requirement for 2021/22

- 3.1 The 2021/22 gross Capital Spend was £360.4m against a budget of £468.8m, an underspend of £108.3m or 23.1%. with most of the spend in the IAS (£282.9m), Education, Youth and Childcare (£26.6m) and HRA (£24.0m).
- 3.2 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.
- 3.3 The 2021/22 outturn position is detailed in table 1 below, including the net financing need for 2021/22.

Table 1: 2021/22 Capital Outturn and Financing

Capital Expenditure by Service	2021/22 Outturn	Mar 2022 Revised Budget	Over / (Under) spend
	£000s	£000s	£000s
Adults Care & Support	1,148	1,582	-434
Community Solutions	70	74	-4
CIL	925	1,501	-576
Culture, Heritage & Recreation	3,107	8,894	-5,787
Enforcement	705	724	-19
Inclusive Growth	4,513	10,236	-5,723
Transport for London schemes	1,114	1,446	-332
My Place	5,548	7,144	-1,596
Public Realm	1,386	1,657	-271
Education, Youth and Childcare	26,592	44,093	-17,501
Devolved Formula Capital	1,857	1,650	207
Other	360	1,765	-1,405
General Fund	47,326	80,766	-33,440
HRA			
Stock Investment (My Place)	16,348	35,129	-18,781
Estate Renewal (Be First)	6,953	5,155	1,798
New Build Schemes (Be First)	667	2,908	-2,241
HRA Total	23,968	43,192	-19,224
IAS			
Residential Developments	271,049	297,689	-26,640
Temporary Accommodation	945	5,749	-4,804
Commercial Investments	10,929	33,321	-22,392
IAS Total	282,923	336,759	-53,835
Transformation			
Dispersed Working	412	1,220	-808
Core	968	2,119	-1,151
ERP	4,813	4,701	112
Transformation	6,194	8,040	-1,846
Approved Capital Programme	360,411	468,757	-108,346
Financed by:			
Grants	-35,644	-69,927	34,283
s106	-29	-254	225
CIL	-1,926	-	-1,926
Capital Receipts	-5,500	-6,094	594
MRR	-17,820	-37,752	19,932
RCCO (GF)	-1,294	-1,968	674
RCCO (HRA)	-5,934	-28,981	23,047
Sub-Total	-68,146	-144,976	76,830
Net financing need for the year	292,265	323,781	-31,515

- 3.4 The movement in the CFR is outlined in table 2 below. Overall, 2021/22 ended with an under borrowed position of £120.2m, calculated as CFR less Total Debt, but was well below the operational boundary and authorised limit.

Table 1: 2021/22 CFR and Borrowing

Prudential Indicator – Capital Financing Requirement			
	£000s	£000s	£000s
Opening CFR at 31 March 2021	1,117,439	1,117,439	0
CFR – General Fund	279,555	305,440	-25,885
CFR – Housing	0	0	0
Total CFR as at 31 March 2022	1,396,994	1,422,879	-25,885
Net movement in CFR	279,555	305,440	-25,885
Net financing need for the year	292,265	323,781	-31,515
Less: MRP*	-12,710	-12,247	-463
Less: Capital Receipts		-6,094	6,094
Movement in CFR	279,555	305,440	-25,885
Long & Short-Term Borrowing	1,079,421	1,063,850	15,571
PFI and finance lease liabilities	197,357	200,365	-3,008
Total debt 31 March 2022	1,276,778	1,264,215	12,563
Operational Boundary	1,700,000	1,700,000	0
Authorised Limit	1,800,000	1,800,000	0
Under/(Over) Borrowing	120,216		

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 2021/22 this was 3.96%, with most of the cost being MRP.
- 4.3 In future the interest payable is likely to increase significantly as the Council continues to borrow and the treasury income is likely to reduce as cash balances are reduced. In addition, as schemes become operational, then interest will no longer be capitalised. At this point the interest costs will be covered, with a margin, from the cashflows coming from the assets being built. There is also forecast to be an increase in investment income from the various investments, including both residential and commercial.

Table 2: Ratio of financing costs to net revenue stream 2021/22

	2021/22 Outturn	Mar 2022 Revised Budget	Over / (Under) spend
	£000s	£000s	£000s
Net Cost of Services	168,614	161,318	7,296
MRP	12,710	12,247	463
GF Borrowing costs	13,536	14,121	- 585
GF Interest Income	-8,495	-6,503	- 1,992
Capitalised Interest (21/22)	-5,463	-5,000	- 463
Investment Income	-5,611	-6,782	1,171
Net GF Cost	6,677	8,083	-1,406
Financing Cost to Net Revenue	3.96%	5.01%	
HRA Interest Payable	10,503	10,503	0
Total Net Cost	17,180	18,586	-1,406

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. The Council's existing level of fixed interest rate exposure is 100.0% and variable rate exposure is 0.0%. Table 3 shows the fixed and variable interest rate exposure.

Table 3: Fixed and variable rate exposure 2021/22 TO 2023/24

Interest rate exposures	2021/22	2022/23	2023/24
	Upper	Upper	Upper
Limits on fixed interest rates based on net debt	100%	100%	100%
Limits on variable interest rates based on net debt	70%	70%	70%
Limits on fixed interest rates:			
• Debt only	100%	100%	100%
• Investments only	90%	90%	90%
Limits on variable interest rates			
• Debt only	70%	70%	70%
• Investments only	80%	80%	80%

6. Maturity Structure of Fixed Rate Borrowing

- 6.1 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 £981.688m of long and short-term borrowing.

Table 4: Borrowing as at 31 March 2022

Maturity structure of fixed interest rate borrowing 2021/22			
	Actual Position	Lower	Upper
Under 12 months	5.84%	0%	50%
12 months to 2 years	0.0%	0%	60%
2 years to 5 years	0.0%	0%	70%
5 years to 10 years	1.85%	0%	70%
10 years and above	92.31%	0%	100%

7. 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:

Maximum principal sums invested > 364 days £'000s	2021/22 £000's	2022/23 £000's	2023/24 £000's
Principal sums invested > 364 days	350,000	300,000	250,000

8.1 Summary Assessment

- 8.1 The outturn position is set out above in respect of the Prudential Indicators approved by Assembly in February 2021.
- 8.2 The outturn figures confirm that the limits and controls set for 2021/22 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 2021/22.