Appendix 1

The Prudential Code for Capital Investment in Local Authorities

1. <u>Introduction</u>

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 2019/20 plus the expected changes to the CFR over 2019/20 from financing the capital programme. This indicator allows the Council some flexibility to borrow in advance of its immediate capital needs in 2019/20.

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 2020 was £1.116bn, which is lower than the Approved Authorised Limit of £1.152bn. It is higher than the Operational Boundary of £1.052bn due to a significant amount of long-term borrowing in February and March 2020 to cover the proposed purchase of the Muller site in Chadwell Heath.

3. Capital Outturn and Capital Finance Requirement for 2019/20

3.1 The overall capital programme is £401.930m of which £81.969m is General Fund, £234.728m Investments, £74.237m is HRA, £10.995m is Transformation and £112k for PFI. Spend against the programme is £220.804m, which is 55.0% of planned 2019/20 spend. This was largely due to underspends in the Investment Strategy and there was slippage on Culture and Heritage as well as Education programmes.

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. The 2019/20 Budget adjustment made related to 2018/19 underspends carried forward into 2019/20 and related to spend commitments (£5.1m). The service has spent 55% of the annual budget in 2019/20.

3.3 The 2019/20 outturn position is detailed below:

Capital Expenditure by Service	2019/20 Outturn	Mar 2020 Revised Budget	Over / (Under) spend
	£000	£000	£000
Adults Care & Support	1,989	2,241	(252)
Community Infrastructure Levy Schemes	316	466	(150)
Community Solutions	23	210	(187)
Core	1,108	3,486	(2,378)
Culture, Heritage & Recreation	1,276	10,696	(9,421)

Education, Youth and Childcare	37,417	46,561	(9,144)
Enforcement	804	2,116	(1,312)
Inclusive Growth	1,860	2,008	(148)
MyPlace	5,207	6,070	(862)
Public Realm	6,104	7,571	(1,468)
Service Development and Integration	(199)	-	(199)
Section 106 Schemes	250	544	(294)
Investment and Acquisition Strategy	119,153	234,728	(115,576)
HRA	41,136	74,237	(33,101)
Transformation	4,248	10,995	(6,747)
Add: PFI Additions (lifecycle costs)	112	112	
Approved Capital Programme	220,804	402,042	(181,238)
Financed by:		[redacted]	[redacted]
Grants	51,658	[redacted]	[redacted]
Section 106	293	[redacted]	[redacted]
CIL	382	[redacted]	[redacted]
Capital Receipts	3,625	[redacted]	[redacted]
HRA Contributions	29,166	[redacted]	[redacted]
Sub-Total	**85,124**	[redacted]	[redacted]
Net financing need for the year	**135,680**	[redacted]	[redacted]
Prudential Indicator – Capital Financing Requirement			
Opening CFR as at 31 March 2019	742,629	743,333	(704)
CFR – General Fund	577,711	630,559	(52,848)
CFR – Housing	290,442	278,472	(11,970)
Total CFR as at 31 March 2020	**868,153**	909,031	(40,878)
Net movement in CFR	**125,524**	165,698	(40,174)
Net financing need for the year	**135,680**	**175,900**	**(40,220)**
Less: MRP/VRP	**(10,156)**	**(10,202)**	**46**
Movement in CFR	**125,524**	**165,698**	**(40,174)**
Long & Short-Term Borrowing	981,688	910,000	71,688
PFI and finance lease liabilities	133,956	134,000	(44)
Total debt 31 March 2020	**1,115,644**	**1,044,000**	**71,644**
Operational Boundary	**1,052,000**	**1,052,000**	**0**
Authorised Limit	**1,152,000**	**1,152,000**	**0**

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 <u>The ratio of financing costs to net revenue stream</u>. This indicator identifies the cost of capital (borrowing and MRP net of investment income) against the net revenue stream. For 2019/20 this was 5.75%, with most of the cost being MRP. 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. There is forecast to be a significant increase in investment income.

Table 2: Ratio of financing costs to net revenue stream 2019/20

General Fund Cost of Capital	2019/20 Actual
Net General Fund Base Budget	148,820
Cost of Capital	
GF Interest Payable	12,374
Treasury Income	- 7,746
Investment Income	- 3,799
MRP	7,731
Net Cost of Capital	8,560
Financing Cost to Net Revenue	5.75%

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 invests in property, 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	2019/20 Actual %	2020/21 Estimate %	2021/22 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 £981.688m of long and short-term borrowing.

Table 4: Borrowing as at 31 March 2020

Maturity structure of fixed interest rate borrowing 2019/20			
	Actual Position	Lower	Upper
Under 12 months	14.88%	0%	40%
12 months to 2 years	3.46%	0%	60%
2 years to 5 years	6.14%	0%	70%
5 years to 10 years	10.35%	0%	70%
10 years and above	65.17%	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	2019/20 £000's Actual	2020/21 £000's Estimate	2021/22 £000's Estimate
Principal sums invested > 364 days	350,000	250,000	200,000

8.1 Summary Assessment

8.1 The outturn position is set out above in respect of the Prudential Indicators approved by Assembly in February 2019.

8.2 The outturn figures confirm that the limits and controls set for 2019/20 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 2019/20.