

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 means that the Council is not borrowing to support revenue expenditure.
- 2.3 Net borrowing must not, except short term, exceeded the Capital Financing Requirement (“CFR”) for 2022/23 plus the expected changes to the CFR over 2022/23 from financing the capital programme. This indicator allows the Council some flexibility to borrow in advance of its immediate capital needs in 2022/23.
- 2.4 The Council uses 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 2023 was £1.55bn, which is lower than the Approved Authorised Limit of £1.70bn and Operational Boundary of £1.60bn. During 2022/23 there were no breaches of these limits.

3. Capital Outturn and Capital Finance Requirement for 2022/23

- 3.1 The capital programme as at 31 March 2023 was £457.1m, including the Travelodge finance lease and consists of £33.1m for the General Fund, £23.8m for HRA, £316.1m for the IAS, £2.1m for Transformation and £82.0m for the Travelodge lease and leaseback arrangement. The total revised budget was £546.7m, with the overall delivery at 83.6m%. A number of schemes completed in 2022/23 and grant was allocated to the schemes as they completed and were handed over to Reside, which reflects the high level of grant. A number of projects will be reprofiled in 2024/25 to take into account the carry forward amounts.
- 3.2 The HRA programme is self-financed 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 HRA spend was a small underspend for stock investment, however this is against a much reduced, revised budget. Estate renewal, including buybacks underspent by £6.1m and this will be carried forward to 202/24.
- 3.3 **The 2022/23 outturn position is detailed below:**

Capital Expenditure by Service	2022/23 Outturn	2022/23 Revised Budget	Over / (Under) spend
	£M	£M	£M
CARE & SUPPORT	2,373	2,456	-83
INCLUSIVE GROWTH	3,655	9,925	-6,269
CIL	314	1,031	-718
TFL	1,515	1,771	-256
COMMUNITY SOLUTIONS	9	15	-6
IT	1,158	1,472	-315
CULTURE & HERITAGE	93	921	-828

PARKS COMMISSIONING	5,747	17,904	-12,158
ENFORCEMENT	103	2,254	-2,151
MY PLACE	5,682	8,867	-3,185
PUBLIC REALM	1,302	1,334	-32
EDUCATION, YOUTH & CHILD	11,177	10,538	639
General Fund	33,125	58,487	-25,361
HRA			
STOCK INVESTMENT	18,665	18,925	-260
ESTATE RENEWAL	4,101	10,247	-6,145
NEW BUILD SCHEMES	1,012	2,045	-1,033
HRA Total	23,779	31,217	-7,438
IAS			
RESIDENTIAL	264,992	323,936	-58,944
COMMERCIAL	51,097	51,578	-481
IAS Total	316,089	375,514	-59,425
TRANSFORMATION	2,106	2,651	-545
Removed Projects	-133	0	-133
Add: Finance Lease (Travelodge)	82,000	78,807	3,193
Approved Capital Programme	457,099	546,675	-89,576
Financed by:			
Grants	-83,525	-107,518	23,993
s106 / CIL	-1,297	-1,631	334
Capital Receipts	-2,304	-2,354	50
MRR	-19,210	-61,926	42,716
RCCO (GF)	-546	-3,206	2,660
RCCO (HRA)	-4,057	0	-4,057
Sub-Total	-110,940	-176,635	65,695
Net financing need for the year	346,159	370,040	-23,881

Prudential Indicator – Capital Financing Requirement			
Opening CFR at 31 March 2022	1,318,023	1,292,374	25,649
CFR – General Fund	327,749	290,953	36,796
CFR – Housing	0	0	0
Total CFR as at 31 March 2023	1,645,772	1,583,327	62,445
Net movement in CFR	327,749	290,953	36,796
Net financing need for the year	346,159	370,040	-23,881
Less: MRP*	-16,106	-15,215	-891
Less: Capital Receipts	-2,304	-65,000	62,696
Movement in CFR	327,749	289,825	37,924
Long & Short-Term Borrowing	1,191,117	1,120,000	71,117
PFI and finance lease liabilities	356,579	276,164	80,415
Total debt 31 March 2022	1,547,696	1,396,164	151,532
Operational Boundary	1,600,000	1,600,000	0
Authorised Limit	1,700,000	1,700,000	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 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 2022/23 this was 3.84%, with most of the cost being MRP. In future the interest payable will increase significantly as the Council continues to borrow and the treasury income is likely to reduce as cash balances are reduced but there will be a significant increase in interest income from loans. There is forecast to be a significant increase in investment income.

Table 2: Ratio of financing costs to net revenue stream 2022/23

General Fund Cost of Capital	2022/23 Outturn	2022/23 Revised Budget	Over / (Under) spend
	£000s	£000s	£000s
Net Cost of Services	211,618	180,944	30,674
Cost of Capital			
<i>MRP</i>	16,106	15,215	891
<i>GF Net Interest Budget</i>	-6,471	5,178	-11,649
<i>Investment Income</i>	-1,501	-6,077	4,576
Net Cost of Capital	8,134	14,316	-6,182
Financing Cost to Net Revenue	3.84%	7.91%	-4.07%

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 is set to ensure 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%. 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: Fixed and variable rate exposure 2022/23 to 2024/25

Interest rate exposures	2022/23	2023/24	2024/25
	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 GF 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 £895.2m GF and £295.9m HRA Borrowing long and short-term borrowing.

Table 4: HRA Borrowing as at 31 March 2023

Maturity structure of HRA fixed interest rate borrowing 2022/23				
	Actual Position £000s	Lower	Lower	Upper
Under 12 months	-	0%	0%	50%
12 months to 2 years	-	0%	0%	60%
2 years to 10 years	-	0%	0%	70%
10 years to 20 years	50,000.00	16.9%	0%	70%
20 years to 30 years	50,000.00	16.9%	0%	100%
30 years to 40 years	185,912.00	62.8%	0%	100%
40 years to 50 years	-	0.0%	0%	100%
50 years and above	10,000.00	3.4%	0%	100%
Total Borrowing	295,912.00	100.0%	0%	100%

Table 5: GF Borrowing as at 31 March 2023

Maturity structure of General Fund fixed interest rate borrowing 2022/23				
	Actual Position £000s	Lower	Lower	Upper
Under 12 months	165,317.03	18.5%	0%	50%
12 months to 2 years	20,000.00	2.2%	0%	60%
2 years to 10 years	10,000.00	1.1%	0%	70%
10 years to 20 years	272,897.89	30.5%	0%	70%
20 years to 30 years	146,990.16	16.4%	0%	100%
30 years to 40 years	90,000.00	10.1%	0%	100%
40 years to 50 years	180,000.00	20.1%	0%	100%
50 years and above	10,000.00	1.1%	0%	100%
Total Borrowing	895,205.09	100.0%	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	2022/23 £000s	2023/24 £000s	2024/25 £000s
Principal sums invested > 364 days	350,000	300,000	250,000

8. Summary Assessment

- 8.1 The outturn position is set out above in respect of the Prudential Indicators approved by Assembly in February 2022.
- 8.2 The outturn figures confirm that the limits and controls set for 2022/23 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 2022/23.