Appendix D

Prudential Code Indicators 2010/2011 to 2012/2013

Local Authorities are required to have regard to the Prudential Code when carrying out their duties under Part 1 of the Local Government Act 2003. The key objectives of the code are to ensure that the capital investment plans of Local Authorities are affordable, prudent and sustainable. A further key objective is to ensure that treasury management decisions are taken in accordance with good professional practice.

It should be noted that accounting regulations relating to the introduction of International Financial Reporting Standards (IFRS) are being introduced that may affect a number of the Council's prudential indicators. In particular, changes to accounting standards for PFI schemes and leasing may require these assets to be brought onto the Council's balance sheet, increasing the Council's capital financing requirement, authorised limit for external debt and operational boundary for external debt. These adjustments are technical in nature and authorities are being consulted on the measures required. A prudent amount has been added to all limits to reflect these potential adjustments, however as guidance has not yet been finalised should any of the Council's prudential indicators be exceeded as a result these changes they will be reported to Cabinet and where appropriate full Council at the next meetings following the change.

The indicators that must be taken into account are shown below:

P1 Actual capital expenditure incurred in 2008/2009 was £123.531 million and the estimates of capital expenditure to be incurred for the current and future years that are recommended for approval are:

Portfolio	Estimated Capital Expenditure			
	2009/10 £'000	2010/11 £'000	2011/12 £'000	2012/13 £'000
Leader / Deputy Leader	1,195	3,800	0	0
Resources	5,291	1,267	205	0
Children & Learning City	55,106	21,410	17,122	11,277
Healthy City	7,750	3,748	2,681	2,786
Attractive & Inclusive City	25,836	22,458	15,919	38,633
Sustainable Communities	5,002	6,163	790	790
Prosperous City	2,363	13,274	1,547	0
Responsive Services & Customer Care	1,595	2,676	400	0
Safer Cities	487	1,425	0	0
Contingencies (including provisions for prudential borrowing and schemes subject to further evaluation and approval)	0	11,614	8,800	50,800
TOTAL	**104,625**	**87,835**	**47,464**	**104,286**

An estimate has been made of future spend on the basis of grants expected to be received in 2010/2011 onwards. Where no formal grant offer has been received for anticipated capital schemes, such as Building Schools for the Future Wave 2, a provision has been made within the Contingencies section in the capital programme detailed above. The profile of expenditure will be updated in the quarterly capital reviews to Cabinet as further projects are approved.

P2 Estimates of the ratio of financing costs to net revenue stream for the current and future years, and the actual figures for 2008/2009 are:

Ratio of financing costs to net revenue stream

2008/2009 Actual	2009/2010 Estimate	2010/2011 Estimate	2011/2012 Estimate	2012/2013 Estimate
2.28%	4.20%	4.83%	5.29%	5.53%

The estimates of financing costs include current commitments and the proposals in the revenue budget and capital programme reports. The forecasts show an anticipated decrease in the ratios of financing costs to net revenue stream than those previously reported in 2008/2009 and 2009/2010 due to the Council achieving a higher than anticipated rate of return on investments in 2008/2009 and through the incorporation of previously excluded general grants such as Area Based Grant in the calculation of the indicator.

The indicators show an increase in anticipated ratios in future years and reflects the fact that significant amounts of expenditure are planned to be financed from earmarked reserves which will lead to investment levels decreasing over time and also due to forecasted low levels of interest rates as a result of the economic downturn, the end of which is uncertain. It should be noted that the ratios will vary depending on the interest rate obtained on investments and the level of investments available. If there is, for example, slippage in use of grants used to fund the capital programme then the ratios shown in the table above will decrease, whilst any reduction in the interest rate obtained on investments, beyond that estimated, will lead to an increase in the reported ratios.

As detailed in section 6.8 of the main report, there are planned voluntary increases to the statutory Minimum Revenue Provision in order that, in relation to non-trading areas, unsupported borrowing taken out and used to fund invest to save schemes is repaid over a shorter time period relating to the savings profile of the particular invest to save scheme. This will lead to a higher ratio in early years but lower ratios over the medium to long-term.

The level of financing costs is considered to be affordable and has been taken into account when assessing the Medium Term Financial Strategy. Please see the report on the Revenue Budget and Proposed Council Tax for 2010/2011.

P3 Estimates of the end of year Capital Financing Requirement for the Council for the current and future years and the actual Capital Financing Requirement at 31st March 2009 are:

Capital Financing Requirement

31/03/09 £000 Actual	31/03/10 £000 Estimate	31/03/11 £000 Estimate	31/03/12 £000 Estimate	31/03/13 £000 Estimate
205,781	294,927	307,627	315,968	320,974

The Capital Financing Requirement measures the authority's underlying need to borrow for a capital purpose. In accordance with best practice, Sunderland City Council does not associate individual borrowing taken out with particular items or types of expenditure. The Authority has an integrated Treasury Management Strategy and has adopted the CIPFA Code of Practice for Treasury Management in the Public Services. The City Council has, at any point in time, a number of cash flows both positive and negative, and manages its treasury position in terms of its borrowings and investments in accordance with its approved Treasury Management Strategy and practices. In day to day cash management, no distinction can be made between revenue cash and capital cash. External borrowing arises as a consequence of all the financial transactions of the authority and not simply those arising from capital spending. In contrast, the Capital Financing Requirement reflects the authority's underlying need to borrow for a capital purpose. The substantial increase in the Capital Financing Requirement at 31/03/10 reflects potential changes arising from compliance with new accounting standards relating to IFRS (these are detailed in section 5.2 of the main report).

P4 CIPFA's Prudential Code for Capital Finance in Local Authorities includes the following as a key indicator of prudence:

> "In order to ensure that over the medium term net borrowing will only be for a capital purpose, the local authority should ensure that net external borrowing does not, except in the short term, exceed the total of the capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years."

The Authority had no difficulty meeting this requirement in 2008/2009, nor are there any difficulties envisaged for the current or future years. This view takes into account current commitments, existing plans, and the proposals in this report and the report elsewhere on today's agenda on the Revenue Budget and Proposed Council Tax 2010/2011.

The Council's net borrowing at 31st March 2009 was £10.094 million and as noted in Prudential Indicator P7 the Council's actual external borrowing was £169.092 million. This variation between actual and net borrowing reflects the cash flow position of the authority and balances held in earmarked reserves. The gap will reduce over time as earmarked reserves are used to fund specific projects.

The benefits of having a high level of investments are that:

- a larger amount of interest will be received that can then be used to help support Council budgets and help deliver strategic plans;
- the Council has greater freedom in making its borrowing decisions and can take out borrowing when the timing is right rather than being potentially subject to market volatility; and,
- the liquidity risk is reduced as having a high level of investments means that in the short term the Council is less at risk should money market funds dry up.

The risks associated with holding a high level of investments are:

- from a reduced level of interest earned to that budgeted for should interest rates reduce; and,
- the risk of counterparties not repaying money the Council invests with them.

The Council has mitigated these risks by having a risk averse Treasury Management Investment Strategy and by detailed monitoring of counterparties through its borrowing and investment strategies and treasury management working practices and procedures.

P5 In respect of its external debt, it is recommended that the Council approves the following authorised limits for its total external debt, gross of investments for the next three financial years, and agrees the continuation of the previously agreed limit for the current year since no change to this is necessary. These limits separately identify borrowing from other long-term liabilities such as finance leases. The Council is asked to approve these limits and to delegate authority to the Director of Financial Resources, within the total limit for any individual year, to effect movement between the separately agreed limits for borrowing and other long term liabilities, in accordance with option appraisal and best value for the authority. Any such changes made will be reported to the Cabinet and the Council at their next meetings following the change.

	Authorised Limit for External Debt			
	2009/2010	**2010/2011**	**2011/2012**	**2012/2013**
	£000	**£000**	**£000**	**£000**
Borrowing	331,759	323,990	323,990	328,447
Other long term liabilities	1,563	91,558	93,053	94,548
Total	**333,322**	**415,548**	**417,043**	**422,995**

The Director of Financial Resources reports that these authorised limits are consistent with the Authority's current commitments, existing plans and the proposals in this report for capital expenditure and financing, and with its approved treasury management policy statement and practices. The Director of Financial Resources confirms that they are based on the estimate of most likely, prudent, but not worst case scenario, with, in addition, sufficient headroom over and above this to allow for operational management, for example unusual cash movements. Risk analysis and risk management strategies have been taken into account, as have plans for capital expenditure, estimates of the Capital Financing Requirement and estimates of cash flow requirements for all purposes. It should be noted that the Council undertakes investment and borrowing on behalf of external bodies such as Tyne and Wear Fire and Rescue Authority. Treasury Management undertaken on behalf of other authorities is included in Sunderland's borrowing limits, however it is excluded when considering financing costs and when calculating net borrowing for the Council. A specific element of risk has also been taken into account for these bodies.

In taking its decisions on the Revenue Budget and Capital Programme for 2010/2011, the Council is asked to note that the authorised limit determined for 2010/2011, (see P5 above), will be the statutory limit determined under section 3(1) of the Local Government Act 2003.

P6 The Council is also asked to approve the following operational boundary for external debt for the same time period. The proposed operational boundary for external debt is based on the same estimates as the authorised limit, but reflects directly the estimate of the most likely, prudent but not worst case scenario level, without the additional headroom included within the authorised limit to allow for example for unusual cash movements, and equates to the maximum of external debt projected by this estimate. The operational boundary represents a key management tool for in year monitoring. Within the operational boundary, figures for borrowing and other long-term liabilities are separately identified. The Council is also asked to delegate authority to the Director of Financial Resources, within the total operational boundary for any individual year, to effect movement between the separately agreed figures for borrowing and other long term liabilities, in a similar fashion to the authorised limit.

The operational boundary limit will be closely monitored and a report will be made to Cabinet and Council if it is exceeded at any point. In any financial year, it is generally only expected that the actual debt outstanding will approach the operational boundary when all of the long-term borrowing has been undertaken for that particular year and will only be broken temporarily as a result of the timing of debt rescheduling. It is considered likely that the Council's set operational boundary for 2009/2010 of £227.212 million will be exceeded as a result of accounting changes relating to the incorporation of IFRS requirements and Cabinet is asked to recommend a revision in the Council's operational boundary for external debt in 2009/2010 to £292.481 million in the light of these changes.

	Operational Boundary for External Debt			
	2009/10	**2010/11**	**2011/12**	**2012/13**
	£000	**£000**	**£000**	**£000**
Borrowing	200,918	235,743	246,126	256,109
Other long term liabilities	91,563	91,558	93,053	94,548
Total	**292,481**	**327,301**	**339,179**	**350,657**

P7 The Council's actual external debt at 31st March 2009 was £169.092 million.

The Council includes an element for long-term liabilities relating to PFI schemes and finance leases in its calculation of the operational and authorised boundaries to allow further flexibility over future financing. It should be noted that actual external debt is not directly comparable to the authorised limit and operational boundary, since the actual external debt reflects the position at any one point in time and allowance needs to be made for cash flow variations.

P8 The estimate of the incremental impact of new capital decisions proposed in this report, over and above capital investment decisions that have previously been taken by the Council are:

For Band D Council Tax

2010/2011	2011/2012	2012/2013
£0.98	£4.51	£6.95

The estimates show the net revenue effect of all capital expenditure from all schemes commencing in 2010/2011 and the following two financial years. The impact on the Band D Council Tax detailed above takes account of estimated government grant funding through General Grants.

These forward estimates are not fixed and do not commit the Council. They are based on the Council's existing commitments, current plans and the capital plans detailed in this report. The cumulative effect of full year debt charges will have an additional impact of £8.21 in 2013/2014. There are no known significant variations beyond the above timeframe that would result from past events and decisions or the proposals in the budget report.

P9 The Council is also required to indicate if it has adopted the CIPFA Code of Practice on Treasury Management. This original 2001 Code was adopted on 20th November 2002 by full Council and the revised Code (see Appendix E in this report) will be adopted on 3rd March 2010.

The objective of the Prudential Code is to provide a clear framework for local authority capital finance that will ensure for individual local authorities that:

(a) capital expenditure plans are <u>affordable;</u>

(b) all external borrowing and other long term liabilities are within <u>prudent and sustainable levels;</u>

(c) treasury management decisions are taken in accordance with professional good practice;

and that in taking decisions in relation to (a) to (c) above the local authority is

(d) <u>accountable</u>, by providing a clear and transparent framework.

Further, the framework established by the Code should be consistent with and support:

(e) <u>local strategic planning;</u>

(f) <u>local asset management planning;</u>

(g) <u>proper option appraisal</u>.

In exceptional circumstances the objective of the Code is to provide a framework that will demonstrate that there is a danger of not ensuring the above, so that the Authority can take timely remedial action.

CIPFA Treasury Management in the Public Services Code of Practice - Indicators 2010/2011 to 2012/2013

P10 It is recommended that the Council sets an upper limit on its fixed interest rate exposures of £90 million in 2010/2011, £115 million in 2011/2012 and £120 million in 2012/2013.

P11 It is further recommended that the Council sets an upper limit on its variable interest rate exposures of £50 million in 2010/2011, £60 million in 2011/2012 and £60 million in 2012/2013.

P12 It is recommended that the Council sets upper and lower limits for the maturity structure of its borrowings as follows:

Amount of projected borrowing that is fixed rate maturing in each period expressed as a percentage of total projected borrowing that is fixed rate at the start of the period:

	Upper limit	**Lower limit**
Under 12 months	40%	0%
12 months and within 24 months	50%	0%
24 months and within 5 years	75%	0%
5 years and within 10 years	100%	0%
10 years and within 20 years	100%	0%
20 years and within 30 years	100%	0%
30 years and within 40 years	100%	0%
40 years and within 50 years	100%	0%
over 50 years	100%	0%

P13 A maximum maturity limit of £100 million is set for each financial year (2010/2011, 2011/2012 and 2012/2013) for long term investments, (those over 364 days), made by the authority. This gives additional flexibility to the Council in undertaking its Treasury Management function. Should the Council appoint any external fund managers during the year, these limits will be apportioned accordingly. The type of investments to be allowed are detailed in the Annual Investment Strategy (Appendix G).

At present the Council has £36.525 million of long-term investments. The main element of this is £35.000 million in term deposits, of which £30.000 million matures in 2010/2011 and £5.000 million matures in 2011/2012. The remaining £1.505 million is the value of share capital held in NIAL Holdings PLC. This equates to a 9.41% share in Newcastle International Airport. The Council also holds £0.020 million in government securities, other shares and unit trusts.