Chester-le-Street
District Council

Report to:	Special Council
Date of Meeting:	2 March 2006
Report from:	Finance and Accountancy Manager
Title of Report:	Prudential Indicators
Agenda Item Number:	

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1. INTRODUCTION

1.1 From 2004/2005 the detailed control exercised for many decades by central government over either or both capital expenditure and borrowing was terminated. In place of the previous controls, the Local Government Act 2003 has introduced the "prudential" approach to borrowing, capital investment and treasury management. In order to set out in detail how local authorities should meet the requirements of the Act, the Chartered Institute of Public Finance and Accountancy has published a Prudential Code which requires local authorities to prepare and publish a number of mandatory prudential indicators by means of which their financial management will be governed. The Local Authority Capital Finance Regulations 2003 endorse the Code and give it the force of statutory regulation.

1.2 The purpose of the indicators is to provide a framework for decision making on capital expenditure. The prudential indicators therefore relate to capital expenditure programmes, and their impact on the revenue budget and provide limits to the associated borrowing. They also encompass investment by the Council, in respect of which the ODPM issued guidance in March 2004. They should cover at least a three year period and are primarily concerned with affordability, prudence and sustainability. The prudential indicators also impact on treasury management strategy, so that both the capital budget and treasury management strategy reports are closely tied into this report.

1.3 The indicators, which must be set by the Council and can be revised during the year (but only by the Council), are detailed below, together with an explanation of the assumptions made in calculating them.

2. ESTIMATED CAPITAL EXPENDITURE

2.1 This indicator measures the total value of the capital programme over at least a three year period, distinguishing Housing capital expenditure from General Fund capital expenditure. The table below is based on the capital programme included elsewhere on the agenda. The table shows actual 2004/2005 capital spending and the probable outturn for 2005/2006 for comparison purposes.

	Actual 2004/2005 £m	Probable 2005/2006 £m	Budget 2006/2007 £m	Budget 2007/2008 £m	Budget 2008/2009 £m
General Fund	5.33	4.30	5.13	1.48	1.00
Housing	4.42	4.47	4.57	4.60	4.64
Total	9.75	8.77	9.70	6.08	5.64

3. ESTIMATED INCREMENTAL IMPACT OF CAPITAL INVESTMENT

3.1 This indicator measures the impact on the Band D council tax level and on the average weekly rent of tenants of any capital investment included above which may involve unsupported borrowing as a means of financing projects. It is not considered that the capital programme above includes any requirement for unsupported borrowing. (Unsupported borrowing means borrowing the revenue costs of which will not feed into the Capital Financing element of the Council's Formula Spending Share and therefore will not be supported by any Government external funding). The capital investment proposed therefore has no impact on council tax or rents.

	Budget 2006/2007 £	Budget 2007/2008 £	Budget 2008/2009 £
Council Tax at Band D	0.00	0.00	0.00
Average Weekly Rent	0.00	0.00	0.00

4. ESTIMATED CAPITAL FINANCE COSTS AS A PERCENTAGE OF NET REVENUE STREAM

4.1 This indicator is a further measure of affordability and measures the proportion of revenue budgets, both General Fund and Housing Revenue Account, which is represented by capital financing costs. These are made up of interest payments on borrowing and other credit arrangements, plus principal repayments less interest earned on investments. The net revenue stream for the General Fund is net expenditure before general government grants and contributions from balances are taken into account, and for the Housing Revenue Account is total income from rents and government subsidy.

	Budget 2006/2007 %	Budget 2007/2008 %	Budget 2008/2009 %
General Fund	1.19	2.02	1.63
Housing	11.19	11.36	11.53

5. ESTIMATED CAPITAL FINANCING REQUIREMENT

5.1 This indicator measures the extent to which capital expenditure has not yet been financed from capital receipts, capital grants or revenue contributions. In other words, it is designed to measure the underlying need to borrow, or finance by other long term liabilities, the Council's capital expenditure.

	Actual 31/03/2005 £m	Probable 31/03/2006 £m	Budget 31/03/2007 £m	Budget 31/03/2008 £m	Budget 31/03/2009 £m
General Fund	-0.38	-0.02	-0.15	-0.28	-0.41
Housing	15.27	15.57	15.76	15.95	16.25
Total	14.89	15.55	15.61	15.67	15.84

This table reflects the principle mentioned in the capital budget report that the Council's plans are based on the use of supported borrowing proposals only. If at any time the use of unsupported borrowing is contemplated the Council would be obliged to consider the long term affordability of the associated costs.

6. BORROWING

AUTHORISED LIMIT

6.1 This represents the upper limit on borrowing to be undertaken by the Council. It reflects a level of borrowing which, while not desirable, would be affordable in the short term, but may not be sustainable in the long term. It is the maximum borrowing envisaged plus some headroom for unexpected movements, and is the statutory limit under Section 3(1) of the Local Government Act 2003.

	Budget 2006/2007 £m	Budget 2007/2008 £m	Budget 2008/2009 £m
Borrowing	20.00	20.00	20.00
Other Long Term Liabilities	0.05	0.05	0.05
Total	20.05	20.05	20.05

OPERATIONAL BOUNDARY

6.2 This indicator represents the focus of day to day Treasury Management activities within the Council. It is the day to day operational limit for the management of external debt to ensure that the Council remains within the authorised limit. It is based on expectations of the maximum external debt according to probable, not possible, events which affect the level of borrowing. It is lower than the authorised limit because, occasionally, breaches of the boundary may occur. This is allowed so long as it is not a sustained breach, whereas the authorised limit should not be breached in any circumstances.

	Budget 2006/2007 £m	**Budget 2007/2008 £m**	**Budget 2008/2009 £m**
Borrowing	15.50	15.50	15.50
Other Long Term Liabilities	0.04	0.04	0.04
Total	15.54	15.54	15.54

The operational boundary has been set at a level below the medium term capital financing requirements in recognition of the fact that it may at any time be more cost effective to reduce investments than to engage in new borrowing, even in the exercise of supported borrowing approvals.

7. COMPLIANCE WITH THE CIPFA CODE OF PRACTICE ON TREASURY MANAGEMENT

7.1 The Council has adopted and incorporated the obligation to comply with the CIPFA Code Practice on Treasury Management into its Financial Regulations and Constitution.

8. INTEREST RATE EXPOSURES

8.1 There are four treasury management prudential indicators. The purpose of these prudential indicators is to contain the activity of the treasury management function within certain limits, thereby reducing the risk or likelihood of an adverse movement in interest rates or borrowing decisions impacting negatively on the Council’s overall financial position. However if these are set to be too restrictive they will impair the opportunities to reduce costs.

8.2 Interest rate risk management is a key element of Treasury Management Strategy. While fixed rate borrowing can reduce uncertainty over future interest rate scenarios, optimum performance may justify the use of variable rates as part of the treasury management portfolio. The purpose of these two indicators is to set maximum limits within which the Council would restricts its exposure to both fixed and variable interest rate movements.

	Budget 2006/2007 £m	Budget 2007/2008 £m	Budget 2008/2009 £m
Upper limit of principal at fixed interest rates	18.00	18.00	18.00
Upper limit of principal at variable interest rates	9.00	9.00	9.00

9. MATURITY STRUCTURE OF BORROWING

9.1 This third treasury management indicator is designed to be a control over an authority having large concentrations of fixed rate debt needing to be replaced at times of uncertainty over interest rates. In effect it is a limit on longer term interest rate exposure. The table shows the maximum percentage of long term debt outstanding due to be repaid within the periods shown which the Council would be prepared to include in its portfolio. These percentages have been set so as to provide the Council with the flexibility to respond to a range of market conditions. There is nothing due for repayment within the next five years because in 2003/2004 the Council repaid early over £5 million of borrowing. These indicators are intended to apply to the Council's portfolio of fixed and variable interest rate separately.

	Budget 2006/2007 %		Budget 2007/2008 %		Budget 2008/2009 %	
	Upper	Lower	Upper	Lower	Upper	Lower
Under 12 months	60	0	60	0	60	0
12 months to 2 years	60	0	60	0	60	0
2 years to 5 years	80	0	80	0	80	0
5 years to 10 years	80	0	80	0	80	0
10 years and above	100	0	100	0	100	0

10. PRINCIPAL SUMS INVESTED

10.1 This fourth treasury management indicator sets a limit on the value of sums to be invested for longer than 364 days. The purpose is to minimise the possibility that long term investments will need to be realised early, which would could have disadvantageous results. Advice from the Council's Treasury Management consultants suggests that it would be prudent to have the option to invest monies for longer than 364 days to take advantage of more favourable interest rates available for these periods.

	Budget 2006/2007 £m	Budget 2007/2008 £m	Budget 2008/2009 £m
Maximum principal sums invested for over 364 days	2.00	2.00	2.00

10.2 These indicators will be monitored on a regular basis and any issues of significance, or any need to vary the indicators, will be reported to Members.

11. RECOMMENDATION

11.1 The Council is recommended to approve the prudential indicators and limits as detailed above in this report.

Ian Herberson	**Contact Details:**
Finance and Accountancy Manager	**Ian Herberson Tel: 0191 3872343**
2 March 2006	**E-mail: ianherberson@**
Version 1.0	**chester-le-street.gov.uk**