Appendix 1

Prudential Indicators 2007/08 to 2009/10

1. The Capital Expenditure Plans

1.1 The Council's capital expenditure plans are summarised below in Table A. Total expenditure is partially funded by resources such as capital receipts, capital grants etc. Any remaining expenditure which cannot be immediately funded from other resources will form a borrowing need.

1.2 A certain level of capital expenditure will be grant supported by the Government; anything above this level will be unsupported and be paid for from the Council's own resources.

1.3 There are two main limiting factors which may impact on the Council's ability to undertake unsupported capital expenditure:

- Whether the revenue resource is available to support in full the implications of capital expenditure, both borrowing costs and running costs.

- The Government may use a control to limit either the total of all councils' plans nationally, or in the event of an assessment by Central Government that local plans are unaffordable at a specific council, it may implement a local control. No such control was implemented during 2006/07, however this is a subject of current debate and the situation may change in the future.

1.4 The key risks to the plans are that the level of Government support has been estimated and is therefore subject to change. Similarly some of estimates for other sources of funding, such as capital receipts, may also be subject to change over this timescale.

1.5 The Council is asked to approve the summary capital expenditure projections below:

Table A:

£000	2006/07 Revised	2007/08 Estimated	2008/09 Estimated	2009/10 Estimated
Capital Expenditure				
Total expenditure	30,099	40,624	27,113	27,665
Financed by:				
Capital receipts	15,116	16,528	9,712	9,906
Capital grants	4,034	2,716	441	450
Revenue	160	0	0	0
Net financing need for the year	10,789	21,380	16,960	17,299

2. The Council's Borrowing Need (the Capital Financing Requirement)

2.1 The second prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR is simply the total outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is a measure of the Council's underlying borrowing need. The net capital financing need (as indicated in Table A) will impact directly on the CFR, along with other factors. The Council is asked to approve the CFR projections below:

Table B:

£000	2006/07 Revised	2007/08 Estimated	2008/09 Estimated	2009/10 Estimated
Capital Financing Requirement				
CFR – Non Housing	113,918	118,630	119,960	122,013
CFR – Housing	82,448	85,859	86,820	88,306
Total CFR	**196,366**	**204,489**	**206,780**	**210,319**
Movement in CFR	(1,702)	8,123	2,291	3,539

2.2 The expected impact of the capital expenditure decisions above on the Council's debt and investment position are shown in the treasury strategy (Appendix 2).

3. Limits to Borrowing Activity

3.1 Within the prudential indicators there are a number of key indicators to ensure the Council operates its activities within well defined limits.

3.2 For the first of these, the Council needs to ensure that its total borrowing (net of any investments) does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2007/08 and next two financial years. This allows some flexibility for limited early borrowing for future years. Table C compares the estimated net borrowing and the CFR.

3.3 It is recognised within the Code (page 24: par. 85) that if a Council holds 'premiums' on their Balance Sheet, in accordance with proper accounting practice, these premiums could cause external borrowing to exceed the CFR limit. In this case, it shall not be construed as a breach of the Code and an additional indicator may be reported to Members for information, showing the CFR including Balance Sheet premiums. It is noted from the figures shown in Table C that this Council is in such a position. However, actual external borrowing is below the level of the CFR plus premiums.

3.4 **The Head of Finance reports that the Council has complied with the requirement to keep net borrowing below the relevant adjusted CFR in 2006/07 (taking account of the position in the Balance Sheet regarding premiums), and no difficulties are envisaged for the current or future years.** This view takes into account current commitments, existing plans, and the proposals in this budget report.

Table C:

£000	2006/07 Revised	2007/08 Estimated	2008/09 Estimated	2009/10 Estimated
Gross Borrowing	201,756	209,879	212,170	215,709
Investments	(129)	(2,279)	(1,429)	(579)
Net Borrowing	**201,627**	**207,600**	**210,741**	**215,130**
CFR	196,366	204,489	206,780	210,319
CRF plus premiums	**218,237**	**225,510**	**226,951**	**229,640**

3.5 A further two prudential indicators control or anticipate the overall level of borrowing. These are:

3.6 **The authorised limit** – This represents a limit which external debt is not allowed to exceed. This needs to be set or revised by Members. It reflects the level of external debt which, while not desired, could be afforded in the short term, but is not sustainable in the longer term.

3.7 **The operational boundary** –This indicator is based on the probable external debt during the course of the year; it is not a limit. Actual external debt could vary around this boundary for short times during the year. It should act as a monitoring indicator to ensure the authorised limit is not breached.

3.8 The Council is asked to approve the following authorised limit and operational boundary:

Table D (£000):

Authorised limit for external debt	**2006/07 Revised**	**2007/08 Estimated**	**2008/09 Estimated**	**2009/10 Estimated**
Borrowing	242,107	251,855	254,604	258,851
Other long term liabilities	0	0	0	0
Total	242,107	251,855	254,604	258,851
Operational boundary for external debt	**2006/07 Revised**	**2007/08 Estimated**	**2008/09 Estimated**	**2009/10 Estimated**
Borrowing	221,932	230,867	233,387	237,280
Other long term liabilities	0	0	0	0
Total	221,932	230,867	233,387	237,280

4. Affordability Prudential Indicators

4.1 The previous sections cover the overall capital and control of borrowing, but within this framework prudential indicators are required to assess the affordability of the capital investment plans. These indicate the impact of the capital investment plans on the overall Council's finances. The Council is asked to approve the following indicators:

4.2 Actual and Estimates of the ratio of financing costs to net revenue stream – This indicator identifies the trend in the cost of capital (loan charges) against the net revenue stream (funding sources e.g. AEF and Council Tax). The estimates of financing costs include current commitments and the proposals in this budget report.

Table E:

	2006/07 Revised	2007/08 Estimated	2008/09 Estimated	2009/10 Estimated
Non-HRA	7.08%	7.02%	7.07%	7.11%
HRA	39.94%	41.92%	42.73%	43.18%

4.3 Estimates of the incremental impact of capital investment decisions on the Council Tax – This indicator identifies the trend in the cost of proposed changes in the three year capital programme recommended in this budget report compared to the Council's existing approved commitments and current plans. The assumptions are based on the budget, but will invariably include some elements which are estimated over the three year period.

Table F:

	Proposed Budget 2007/08	Forward Projection 2008/09	Forward Projection 2009/10
Council Tax - Band D	£19.10	£19.10	£19.10

4.4 Estimates of the incremental impact of capital investment decisions on Housing Rent levels – Similar to the Council tax calculation this indicator identifies the trend in the cost of proposed changes in the housing capital programme recommended in this budget report compared to the Council's existing commitments and current plans, expressed as a discrete impact on weekly rent levels.

Table G:

	Proposed Budget 2007/08	Forward Projection 2008/09	Forward Projection 2009/10
Weekly Housing Rent levels	£0.69	£0.69	£0.69

Appendix 2

Treasury Management Strategy 2007/08 – 2009/10

1. Background

1.1 The treasury management service is an important part of the overall financial management of the Council's affairs. Whilst the prudential indicators in Appendix 1 consider the affordability and impact of capital expenditure decisions, the treasury service covers the effective funding of these decisions. There are specific treasury prudential indicators included in this strategy which need approval.

1.2 The Council's treasury activities are strictly regulated by statutory requirements and a professional code of practice (the CIPFA Code of Practice on Treasury Management). This Council adopted the Code of Practice on Treasury Management on 27 March 2002, and as a result adopted a Treasury Management Policy Statement within its Treasury Management Practices. This meets the requirements of the first of the treasury prudential indicators.

1.3 The policy requires an annual strategy to be reported to Council outlining the expected treasury activity for the forthcoming year. A further report is produced after the year-end to report on actual activity for the year.

1.4 This strategy covers:

- The current treasury position
- The expected movement in interest rates
- The Council's borrowing and debt strategy
- Specific limits on treasury activities
- Treasury performance indicators

2. The Current Treasury Position

2.1 The current position of external borrowing for 2006/07 to 2009/10 is as noted in Table H. This takes account of expected capital expenditure and annual repayments in each year. It also notes the level of anticipated investments due to capital and revenue balances held.

Table H:

£000	**2006/07 Revised**	**2007/08 Estimated**	**2008/09 Estimated**	**2009/10 Estimated**
External Debt				
Borrowing	201,756	209,879	212,170	215,709
Other long term liabilities	0	0	0	0
Debt at 31 March	**201,756**	**209,879**	**212,170**	**215,709**
Investments				
Total Investments at 31 March	129	2,279	1,429	579

3. Expected Movement in Interest Rates

3.1 Interest rate uncertainty is set to persist in the year ahead. The threat of higher inflation is considered a real danger for the UK economy in the near term, not least the possibility that an annual increase in RPI of close to 4% in January 2007 could translate to a buoyant pay round.

3.2 The Bank of England remains concerned that domestically generated inflation could strengthen in the month's ahead and could increase to unacceptably high levels. The key in this respect lies in a number of relationships within the economy:

- ✓ The buoyancy of the international economy and the effect upon UK growth.
- ✓ The strength of domestic activity and the extent of spare capacity.
- ✓ The state of the labour market and the outcome of the forthcoming pay round.
- ✓ The strength of domestic demand and the pricing power of companies.

3.3 UK growth has been stronger than expected. This has been driven mainly by domestic factors, in particular the buoyancy of consumer spending. While the recent rise in official interest rates may lead to some deceleration, the extent of this is expected to be comparatively modest.

3.4 Long-term interest rates have been underpinned by the twin effects of concerns about domestic inflation prospects and the unexpected buoyancy of the US and German economies. Uncertainties generated by these developments are likely to underpin yields in the months ahead, although market conditions will remain erratic and occasional phases of downbeat economic data should generate declines in interest rates.

3.5 However, these phases will prove temporary until the markets are convinced the US economy has unquestionably entered a weaker activity phase and a return to lower dollar interest rates is a near certainty. This coupled with evidence of decelerating activity and moderating inflation on the domestic front should create conditions for a sustainable, yet moderate, decline in long-term yields.

Table I:

Percent (%)	Base Rate	5-year Gilt	20-yr Gilt
2006/07	4.8	4.9	4.4
2007/08	5.3	5.1	4.6
2008/09	5.0	4.8	4.5
2009/10	4.8	4.5	4.3

* Source: Butlers' Medium Term UK rate forecasts – Annual Average (January 2007)

4. Borrowing and Debt Strategy 2007/08 – 2009/10

4.1 The uncertainty over future interest rates increases the risks associated with treasury activity. As a result the Council will take a cautious approach to its treasury strategy.

4.2 Long-term fixed interest rates are expected to rise modestly and base rates are expected to peak at 5¼%. The Head of Finance, under delegated powers, will take the most appropriate form of borrowing depending on the prevailing interest rates at the time, taking into account the risks shown in the forecast above. It is likely that longer term fixed rates will be considered if borrowing levels remain relatively low.

4.3 With the likelihood of increasing interest rates debt restructuring is likely to take place later in the financial year or in future years, although the Head of Finance and treasury consultants will monitor prevailing rates for any opportunities during the year. The expected borrowing requirement is:

Table J:

£000	2006/07 Revised	2007/08 Estimated	2008/09 Estimated	2009/10 Estimated
Movement in CFR	(1,702)	8,123	2,291	3,539
Maturing Debt	487	30	32	33
Total borrowing need	**(1,215)**	**8,093**	**2,259**	**3,506**

5. Investment Strategy 2007/08 – 2009/10

5.1 The main principle governing the Council's investment criteria is security and liquidity before interest return - although the return on the investment will be a consideration. After this main principle the Council will ensure:

- It has sufficient liquidity in its investments. For this purpose it will consider the maximum periods for which funds may prudently be committed.

- It maintains a policy covering both the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security, and monitoring their security.

The Head of Finance will maintain a counterparty list in compliance with the council's Treasury Management Practices and will revise the criteria and submit it to Council for approval as necessary.

5.2 Expectations on shorter-term interest rates, on which investment decisions are based, show a likelihood of peaking at 5¼% in early 2007. The Council's investment decisions are based on comparisons between the rises priced into market rates against the Council's and advisers own forecasts. It is likely that investment decisions will be made for longer periods with fixed investments rates to lock in good value and security of return if opportunities arise. The Director of Finance, under delegated powers, will undertake the most appropriate form of investments depending on the prevailing interest rates at the time, taking into account the risks shown in the forecast above.

6. Treasury Management Prudential Indicators and Limits on Activity

6.1 There are four further treasury prudential indicators. The purpose of these prudential indicators is to contain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of an adverse movement in interest rates. However if these are set to be too restrictive they will impair the opportunities to reduce costs. The indicators are shown within Table K:

- *Upper limits on variable interest rate exposure* – This indicator identifies a maximum limit for variable interest rates based upon the debt position net of investments

- *Upper limits on fixed interest rate exposure* – Similar to the previous indicator this covers a maximum limit on fixed interest rates.

- *Maturity structures of borrowing* – These limits are set to reduce the Council's exposure to large fixed rate sums falling due for refinancing.

- *Total principal funds invested for greater than 364 days* - in Scotland, councils cannot currently invest for periods greater than one year.

Table K:

		2007/08 Upper		**2008/09 Upper**		**2009/10 Upper**
Limits on fixed interest rates		100%		100%		100%
Limits on variable interest rates		30%		30%		30%
Maturity Structure of fixed interest rate borrowing						
	Lower	**Upper**	**Lower**	**Upper**	**Lower**	**Upper**
Under 12 months	0%	10%	0%	10%	0%	10%
12 months to 2 years	0%	10%	0%	10%	0%	10%
2 years to 5 years	0%	30%	0%	30%	0%	30%
5 years to 10 years	0%	50%	0%	50%	0%	50%
10 years and above	0%	100%	0%	100%	0%	100%
Maximum principal invested > 364 days	£nil		£nil		£nil	

7. Performance Indicators

7.1 The Code of Practice on Treasury Management requires the Council to set performance indicators to assess the adequacy of the treasury function over the year. These are distinct historic indicators, as opposed to the prudential indicators, which are predominantly forward looking. Examples of performance indicators often used for the treasury function are:-

- Debt – Borrowing - Average rate of borrowing for the year compared to average available

- Debt – Average rate movement year on year

The results of these indicators will be reported in the Treasury Annual Report for 2006/07.