

Prudential Indicators 2007/08 to 2010/11

1. The Capital Expenditure Plans

- 1.1** The Council's capital expenditure plans (HRA and General Services) 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 2007/08, however, this is a subject of current debate and the situation may change in the future.
- 1.4** The level of government support has been provided as part of the settlement for the period 2008/09 to 2010/11 and is, therefore, unlikely to change. However, some of the estimates for other sources of funding, such as capital receipts, may be subject to change over this timescale.
- 1.5** The Council is asked to approve the summary capital expenditure projections below:

Table A:

£000	2007/08 Revised	2008/09 Estimated	2009/10 Estimated	2010/11 Estimated
Capital Expenditure				
Total expenditure	33,145	39,530	29,451	33,028
Financed by:				
Capital receipts	8,230	15,477	7,231	9,726
Capital grants	7,762	6,146	6,249	7,114
Govt supported borrowing	5,155	5,070	5,070	5,070
Revenue	29	0	0	0
Net financing need for the year	11,969	12,837	10,901	11,118

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 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. The Council is asked to approve the CFR projections below:

Table B:

£000	2007/08 Revised	2008/09 Estimated	2009/10 Estimated	2010/11 Estimated
Capital Financing Requirement				
CFR – Non Housing	120,642	122,680	123,672	124,646
CFR – Housing	84,680	86,110	86,807	87,490
Total CFR	205,332	208,790	210,479	212,135
Movement in CFR	3,404	3,468	1,689	1,657

- 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 2008/09 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.

Table C:

£000	2007/08 Revised	2008/09 Estimated	2009/10 Estimated	2010/11 Estimated
Gross Borrowing	210,994	214,462	216,151	217,807
Investments	10,908	1,577	(235)	(1,085)
Net Borrowing	200,086	212,885	216,386	218,892
CFR	205,332	208,790	210,479	212,135
CRF plus premiums	226,372	228,990	229,829	231,485

- 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 Executive Director of Corporate Services reports that the Council has complied with the requirement to keep net borrowing below the relevant adjusted CFR in 2007/08 to date, and no difficulties are envisaged for the current or future years. This view takes into account current commitments, existing plans, and the proposals in the 2008/09 capital plan.
- 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	2007/08 Revised	2008/09 Estimated	2009/10 Estimated	2010/11 Estimated
Borrowing	253,193	257,354	259,381	261,369
Other long term liabilities	0	0	0	0
Total	253,193	257,354	259,381	261,369
Operational boundary for external debt	2007/08 Revised	2008/09 Estimated	2009/10 Estimated	2010/11 Estimated
Borrowing	232,093	235,908	237,766	239,588
Other long term liabilities	0	0	0	0
Total	232,093	235,908	237,766	239,588

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:

4.1.1 **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:

	2007/08 Revised	2008/09 Estimated	2009/10 Estimated	2010/11 Estimated
Non-HRA	7.10%	6.73%	6.76%	6.79%
HRA	40.13%	40.28%	41.05%	41.47%

4.1.2 **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 2008/09	Forward Projection 2009/10	Forward Projection 2010/11
Council Tax - Band D	£6.51	£6.51	£6.51

4.1.3 **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 2008/09	Forward Projection 2009/10	Forward Projection 2010/11
Weekly Housing Rent levels	£1.75	£1.75	£1.75

Treasury Management Strategy 2007/08 – 2010/11

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 economic climate and 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 2007/08 to 2010/11 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	2007/08 Revised	2008/09 Estimated	2009/10 Estimated	2010/11 Estimated
External Debt				
Borrowing	210,994	214,462	216,151	217,807
Other long term liabilities	0	0	0	0
Debt at 31 March	210,994	214,462	216,151	217,807
Investments				
Total Investments at 31 March	10,908	1,577	(235)	(1,085)

3. Economic Indicators

3.1.1 Current Economic Situation - While the December and February cuts in Bank Rate ultimately came as no great surprise to the financial markets, it did reflect the Monetary Policy Committee's growing unease about the state of the domestic economy. The November Inflation Report did highlight the threat of a comparatively steep decline in economic activity in 2008. However, until then there had been few decisive signals that this process had commenced in earnest.

3.1.2 The cooling in the housing market has been noted for some time, however, the deciding factors behind the MPC's decision to reduce base rates were probably the November CIPS surveys of the manufacturing and service sectors. Both these indicators pointed towards a marked deceleration in activity on a broad front and may well have been interpreted by the policy doves as a sure sign that the effects of the summer's credit squeeze are beginning to spread beyond the confines of the financial markets.

3.2.1 Short Term Interest Rates - The squeeze on credit represents a sharp and involuntary tightening of domestic monetary policy. The fact that it is likely to take some time to evaporate suggests that consumers' expenditure will eventually respond through a marked contraction. This, along with an easing of capacity constraints as the economy slows down, is expected to reduce inflation pressures and ensure CPI growth reverts to the 2% central target rate over the medium term.

3.2.2 Nevertheless, although the Bank of England does note that the upside risks to inflation remain, many of the current pressures are externally generated (oil, food, commodity prices etc) and will not respond to UK interest rate policy.

3.3.1 Longer Term Interest Rates - Bond markets (which underpin the Council borrowing rates) will remain aware of the risks policy makers are taking with inflation for the sake of engineering a gradual and moderate dip in economic activity. Concerns about the health of the financial sector will persist for some time and these will maintain the downward bias to bond yields in the near term.

3.3.2 However, investors may be unsettled by the risks central banks are taking with long-term inflation control in their attempts to shore up faltering activity. Worries about inflation prospects in the medium to long term are expected drive yields higher through 2008/09 and beyond.

Table I:

Percent (%)	Base Rate	5-year Gilt	20-yr Gilt
2007/08	5.6%	5.3%	4.9%
2008/09	4.8%	4.7%	4.8%
2009/10	4.8%	4.8%	4.7%
2010/11	5.0%	4.9%	4.8%

* Source: Butlers' Medium Term UK rate forecasts – Annual Average (January 2008)

4. Borrowing and Debt Strategy 2007/08 – 2010/11

- 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 be higher over the medium term. The Executive Director of Corporate Services, 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 earlier if borrowing rates deteriorate.
- 4.3** A key change in the options for borrowing and rescheduling occurred on 1 November 2007 when the PWLB changed its interest rate structure to a more sensitive pricing method and also increased the relative cost of repaying debt. This will prompt a more cautionary approach to both borrowing and rescheduling. Revenue savings that would have traditionally been realised through debt rescheduling will be restricted due to the inability of the Council to match discounts and premiums on future rescheduling opportunities due to changes in legislation.

Table J:

£000	2007/08 Revised	2008/09 Estimated	2009/10 Estimated	2010/11 Estimated
Movement in CFR	3,404	3,468	1,689	1,657
Maturing Debt	30	32	33	34
Annual borrowing need	3,434	3,500	1,722	1,691

- 4.4** Internal developments such as the phase II schools regeneration projects (as reported to Council in January 2008) which are still in early stages, will be incorporated into the debt strategy when appropriate.

5. Investment Strategy

- 5.1.1** 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 the category of investment types it will invest in (criteria for choosing investment counterparties with adequate security) and monitoring their security.

- 5.1.2** The Scottish Government has issued draft Investment Guidance to come into force on 1 April 2008 which states that the Council should prepare and approve a detailed Investment Strategy before the start of the financial year to which it relates. This draft guidance, which gives more freedom to councils at present, is not yet out for consultation (12 week period required for this) and will not be amended or enacted by 1 April 2008.
- 5.1.3** External Audit have also recommended to the Council (Audit and Performance Review committee 12 December 2007) that the current investment strategy be updated.
- 5.1.4** However, until the time the Guidance is enacted, the Council will continue its current policy – maintaining all investments less than one year and avoiding funds, Gilts, corporate bonds, etc. The Council’s policy will be amended and reported to Council for approval as and when the Investment Guidance is enacted.
- 5.1.5** The Executive Director of Corporate Services 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 the current 5.25% Bank Rate being the peak with the next fall in early 2008. 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, subject to over riding credit counterparty security. The Executive Director of Corporate Services, 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:

	2008/09 Upper		2009/10 Upper		2010/11 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 sums invested > 364 days	£nil		£nil		£nil	

7. Performance Indicators

7.1.1 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

7.1.2 The results of these indicators will be reported in the Treasury Annual Report for 2007/08.