North Tyneside Council

A Local Prudential Code for North Tyneside 2012-2022

widening horizons

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A LOCAL PRUDENTIAL CODE FOR NORTH TYNESIDE

EXECUTIVE SUMMARY

Introduction

The Local Prudential Code plays a key role in capital finance at North Tyneside Council (the “Council”). It allows us to determine our own programme for capital investment in fixed assets that are central to the delivery of quality public services and the identified priorities of the Council as laid out in the Council Strategic Plan.

The Prudential Code was developed by the Chartered Institute of Public Finance and Accountancy (CIPFA), as a professional code of practice to support local authorities in taking their decisions. Local Authorities are required by Regulation to have regard to the Prudential Code when carrying out their duties in England and Wales under Part 1 of the Local Government Act 2003.

The Prudential framework was first introduced in 2004, replacing the previous complex regulatory regimes. It was fully revised in 2009 following a period of consultation and now incorporates changes as a result of the move to International Financial Reporting Standards. It emphasises the links with strategic planning and asset management. The Prudential framework requires local authorities to demonstrate that its capital expenditure is prudent, affordable and sustainable. The framework is underpinned by a set of Prudential Indicators.

This Local Code, which helps to inform decisions on borrowing requirements for capital investment is reviewed annually to ensure value for money and affordability, where it may be used to help deliver strategic and/or neighbourhood projects.

Objectives

The key objective of this Code for the Council is to ensure, within a clear framework, that our Capital Plans are affordable, prudent and sustainable. A further objective is to ensure that treasury management decisions are taken in accordance with good professional practice and in a manner that supports prudence, affordability and sustainability. This Code also ensures that the Council’s capital investment finance initiatives are consistent with and support capital planning, local asset management planning and proper option appraisal.

To demonstrate that the Council has fulfilled its objectives, this Local Code sets out the indicators which must be used, and the factors that must be taken into account.

Process and Governance Issues

This Local Code sets out a clear governance procedure for the setting and revising of prudential indicators. This will be done by full Council as part of the budget setting process each year as, for North Tyneside Council, this is the body that takes the decisions to approve the Council Strategic Plan and Budget Setting process. The chief finance officer is responsible for ensuring that all matters required to be taken into account are reported to

Council for consideration, and for establishing procedures to monitor performance. Any revisions must be reported through the financial management process to Cabinet.

Matters required to be taken into account

In setting or revising its Prudential Indicators, the Council is required to have regard to the following matters:

- Affordability, eg implications for Council Tax and Council Housing Rents;
- Prudence and sustainability, eg implications for external borrowing and whole life costing;
- Value for money, eg options appraisal;
- Stewardship of assets, eg asset management planning;
- Service objectives, eg strategic planning for the authority;
- Practicality, eg achievability of the forward plan; and,
- Risk, eg level of acceptability to the authority.

Following the revision of the Prudential Code in 2009, the Council is also required to take into account its Private Finance Initiative projects in setting or revising its prudential indicators.

The Local Government Act 2003 refers to affordability. In this context, the term affordability has a natural and unrestricted interpretation. The Council must consider the affordability of its capital investment during all the years in which it will have a financial impact. Also, in order to ensure long term affordability, decisions have to be prudent and sustainable in the long term. The Council must also have regard to wider management processes in accordance with good professional practice.

National Financial Situation

This Local Code is revised annually to reflect changes in the national economy and in the local government financial position. All of our investments will continue to be made in line with our Treasury Management Strategy. The Codes for the last few years have been drawn up amid concern regarding the national financial position and the effects of the economic downturn on the national economy. The emphasis for 2012/13 and the following years continues to be the level of public sector debt and central government's plans to reduce it. Those plans, directly affecting local authorities' revenue and capital spend, were embodied in the Coalition Government's Spending Review.

The Government Spending Review announced on 20 October 2010, set out details of the Departmental Expenditure Limits (DELs) allocated across government departments for the four year period from 2011/12 to 2014/15. In order to eliminate the public sector structural budget deficit by 2015, the Spending Review set out £81bn of national expenditure reductions by 2014/15. This equated to an average 19% reduction to departmental budgets over the four years from 2011/12. For Local Government, funding for annual expenditure was set to reduce by 20% in cash terms or 28% in real terms. Most of this reduction was by way of Formula Grant, the annual revenue grant which, in North Tyneside's case, supports approximately half of the Council's net revenue expenditure.

The detailed implications of the first two years of the Spending Review for North Tyneside Council were confirmed in the final Local Government Finance Settlement for 2011/12 (31 January 2011) and the indicative final Local Government Finance Settlement for 2012/13 (7 February 2011). These settlements showed a Formula Grant reduction of over £20 million alone for North Tyneside Council for this two year period.

Looking further ahead to 2013/14, there is likely to be a two year Local Government Finance Settlement to match the final two years of the Spending Review period. This Settlement will also outline the first year's figures taking into account the Government's Local Government Resource Review in relation to the local retention of business rates.

The indicative final Local Government Finance Settlement for 2012/13 has set out a Formula Grant Reduction of £7.6 million (8.4%) for North Tyneside Council. This reflects the fact that North Tyneside Council has been determined as a Band 2 authority for the current 2 year Settlement, with Band 1 reflecting those councils most reliant on Formula Grant and Band 4 applying to those authorities least reliant on Formula Grant. As a continuation of the 2011/12 Formula Grant Settlement, which resulted in approximately £2bn of a total of £3.4bn specific grants being rolled into Formula Grant, this continues into 2012/13. These grants for North Tyneside Council total £8.611m in 2012/13 (£8.713m in 2011/12).

Capital Spending and Funding

The Spending Review stated that nationally, public sector capital spending is projected to fall from £51.6bn in 2010/11 to £40.2bn by 2014/15, an overall reduction of 29%.

For local authorities the prudential borrowing system still remains in place. Capital funding from all government departments to councils is expected to fall by 45% over the four years of the Spending Review, with a reduction of 60% for Education. However, once spending financed by local authority budgets is factored in then the actual reduction nationally is forecast to fall to about 30%. The amount of self-financed capital expenditure by councils is forecast to fall nationally by 17% over the four years of the Spending Review. A consultation has recently closed on the proposed Tax Increment Financing Scheme (whereby councils will be able to borrow against future increases in business rates) and future incentives and planning powers open to local authorities to support growth. Further analysis of the outcome of this will need to be undertaken.

Of importance to the Local Prudential Code was the announcement in the Spending Review that the interest rates for Public Works Loans Board (PWLB) borrowing were to be increased by an average 1% above UK Government gilts with immediate effect. In actual terms this meant an immediate across the board increase in PWLB rates of approximately 0.9%, ending the era of unusually low interest rates for council borrowing. This has led to increased annual interest costs where borrowing is used to finance capital expenditure and so is directly relevant to this Local Prudential Code.

It is anticipated that this increase in rate will continue during 2012/13 and future years and therefore this Local Code is written on this basis.

Housing Revenue Account Self Financing

Under powers now enacted under the Localism Act, the current subsidy system will be replaced with a “self-financing” system, where local authorities will be able to retain all housing rents they collect, in return for a one-off debt settlement. Depending on whether an authority is currently a net payer or receiver of subsidy, they will either have to make a one-off payment, or have a portion of their existing debt paid off.

As a net-payer, North Tyneside Council will take on debt estimated at £129.834m. The final settlement to be received in January 2012 will set out the sum which the Council will need to pay to the Government on 28 March 2012.

This is directly relevant to this Local Code as the Council will need to take out borrowing to fund this one-off payment. Although the Council will no longer be paying across subsidy, the debt repayments, including interest, will take up the majority of the additional income retained, particularly in the short-term.

The Council’s overall position, as a result of prudential borrowing in recent years to support the delivery of the capital programme, is that the Council’s total debt position on the Housing Revenue Account which will be around £20m above the cap set by the Government, i.e. the maximum amount of debt they expect councils to hold. The Government have indicated they are prepared to flex the cap to the level of our actual debt. This will mean that any additional resources available in the early years of the settlement will primarily need to be used to reduce or fund the servicing of existing and new debt.

Implications for North Tyneside Council

Confirmation of the capital reductions for individual authorities were set out in the Local Government Finance Settlement. As set out in the Spending Review these reflect a major contraction in local authority capital spend over the four year period which began in 2011/12.

North Tyneside Council's proposed Capital Plan shows a continuation of the lower level of spend compared to the previous years. Total capital expenditure is budgeted to be approximately £49.434m in 2012/13. The level of "council contribution" (essentially the amount of capital financing the Council has to find from capital receipts and borrowing) falls from a 2011/12 budgeted figure of £29.050m to £15.858m in 2012/13. In particular, the level of unsupported borrowing (for both General Fund and Housing Revenue Account) falls from the budgeted level of £14.574m in 2011/12 to £6.439m in 2012/13.

These reductions reflect stabilisation, in 2012/13, of the Council's capital expenditure from the relatively high levels prior to 2011/12. The reductions in Formula Grant have required major savings to be achieved in the revenue budget and this restricts opportunities for financing the annual costs of additional borrowing for new capital schemes. The rise in PWLB rates also increases the annual revenue costs of any financing from borrowing. The issue of the ongoing affordability of capital schemes therefore remains of primary importance in financial planning over the period of the Spending Review.

Affordability

The fundamental objective in the consideration of the affordability of the Council's Capital Plan is to ensure that the total capital investment of the authority remains within sustainable limits and the impact on the 'bottom line' Council Tax is considered. Affordability is ultimately determined by a judgement about acceptable Council Tax levels and, in the case of the Housing Revenue Account, acceptable rent levels.

In considering the affordability of its Capital Plans, the Council is required to consider all of the resources currently available to it / estimated for the future, together with the totality of its Capital Plans, revenue income and revenue expenditure forecasts for the forthcoming year and following two years as part of the three-year Council Strategic Plan and Budget Setting process. The Council must also consider known significant variations beyond this timeframe as there is a well established ten-year Capital Plan for the Council.

The approach that is proposed for 2012-2015 builds on the process that is currently in place. The resources required, or indicated as required, as part of the resource planning process for 2011-2015 have been reviewed during the current year in light of a number of factors:

(a) Progress on delivering 2011/12 budget plans, workforce development plans, asset management plans (including Information Communication Technology (ICT), accommodation and transport requirements) and sustainability;

(b) Review of the Change, Efficiency and Improvement Programme savings which have been set for each theme, and the options put forward to reach these targets;

(c) Review of the current financial plan forecasts and commitments for general fund revenue, capital investment and housing finance;

(d) This review of the Local Prudential Code for unsupported borrowing; to ensure value for money and affordability where it may be used to help deliver strategic and / or neighbourhood projects;

(e) Due consideration of any partnership resources, changes and/or commitments. This will include examining opportunities with the Council's strategic partners to harness public and voluntary sector resources to support delivery of the Sustainable Community Strategy;

(f) Review of the current Financial Strategy, including reserves and balances in line with the Reserves and Balances Policy formally approved by Council on 3 March 2011; and

(g) The Council Strategic Plan and Budget Setting process planning impact of any new or revised priorities that may be considered for inclusion in the Council Strategic Plan for 2012-2015.

In addition to this, the Council will refresh the ten-year capital investment programme for 2012-2022 that will continue to focus on longer-term investment for the borough, together with local investments over the next ten years, taking account of the continued implications for the Council of the government's Spending Review. This exercise includes an assessment of resource needs and is linked to decisions made in relation to setting the revenue budgets of the Council. We will need to ensure the following are in place to achieve this:

- Prudential borrowing and land sale receipts to support local capital investment priorities or invest to save schemes that will secure greater revenue efficiencies over the three -year financial planning period; and

- Asset management plan updated on an annual basis and acknowledging available budget resources.

In looking at capital investment in the Borough over the longer term, the Council is aware of a number of factors which will impact on the resources available. These will need to be taken into account to ensure the plan remains affordable.

As we already have a 10 year Capital Plan, changes to the Plan are expected to be minimal. In addition, as part of the financial strategy is to reduce the level of new council borrowing, the number of new schemes requiring funding by council contribution will necessarily be limited. The emphasis will therefore be on those proposed new capital schemes which will deliver the Change, Efficiency and Improvement Programme, i.e are either externally funded or which can clearly demonstrate future budget savings, (invest to save schemes).

Whilst decisions around budget-setting are approved on an annual basis, the Council must demonstrate longer-term planning around the use of its resources. Annual budget decisions should be taken in the context of a three-year financial plan that looks at all Council services as part of our Change, Efficiency and Improvement Programme and also takes into account the Government's Spending Review agenda.

Annual budget planning is an integral part of our Council Strategic Plan and Budget Setting process. It is important that the Council Strategic Plan priorities drive the allocation of resources including financial considerations. The final Local Government Finance Settlements for 2011/12 and 2012/13 has added a degree of certainty in respect of our short term financial plans and the Indicative settlement for the following 2 years provides information for our medium term planning timeframe. The Council has also strengthened the linkages between the Council Strategic Plan, financial plan and ten-year Capital Plan, supported by a set of medium-term financial strategy principles. These principles cover the following financial themes:

- Council Tax;
- Income Generation;
- Revenue Expenditure & Budget Strategy;
- Capital Financing and Expenditure;
- Treasury Management; and,
- Risk Management.

The Financial Strategy is prepared taking into account the information received as part of these Government announcements.

2012-2015 Financial Strategy

This year, there is a move to a three-year planning timeframe from our previous four year process. This is due to a number of factors – most significantly, the Spending Review 2010 detailed in the paragraphs above was a four year review with an initial, two-year indicative settlement and forecasts for the following two years. Hence, information is only available to cover the period to the end of the 2014/15 financial year.

It is imperative that the Council has a Financial Strategy that can support service delivery and be flexible enough to enable opportunities to be explored, enable challenges to be fully costed and ensure that the implications of those challenges are fully understood by decision-makers. We need a financial resource base that demonstrates our resources are driven by our Council Strategic Plan. Our Council Strategic Plan and Budget Setting process helps the Council respond appropriately to responsibilities and duties placed upon Local Government through legislative requirements and the Government's drive for a deliverable programme of efficiency savings.

Financial planning is of critical importance during the period of the government's own spending review. This planning is supported by the continuing need to integrate revenue, capital, asset and treasury planning, driven further by the Prudential Code requirements in relation to longer-term capital investment. In formulating the financial plan, the impact of priorities, objectives and preferred options needs to be fully evaluated.

Whilst decisions around budget-setting are approved on an annual basis, the Council must demonstrate longer-term planning for the use of its resources. Annual budget decisions should be taken in the context of a medium term financial plan that looks at all Council services and takes into account the Government's Local Government Finance Settlement agenda.

Good practice highlights the need for longer term planning horizons. The Council's three-year planning timeframe will assist in ensuring there is a clear demonstration of sustainability in its plans for the future. The key drivers for change and the improvement focus in the Council Strategic Plan and Budget Setting process include the need for:

(a) Longer-term planning horizons – for workforce, assets, finance;

(b) Financial flexibility;

(c) Driving value for money and efficiency gains;

(d) Joined-up performance management;

(e) Strong financial awareness;

(f) Effective risk management;

(g) More rapid accounts closure;

(h) Continuous forecasting and in-year reporting; and,

(i) Effective use of technology.

The approach to resource planning for 2012-2015 has concentrated on ensuring that all of the above drivers are embedded into the decision-making process for the allocation and re-direction of the Council's finite resources, financial and otherwise. In addition, there has been a review of the current financial plan forecasts and commitments for general fund revenue, capital investment and housing finance. The Financial Strategy has been subject to its annual review.

The Financial Strategy is a key component of the Council's Council Strategic Plan and Budget Setting process, ensuring that all resources are directed towards achievement of the Council's priorities. The strategy describes the financial direction of the Council and outlines the key financial pressures over a three-year period. It provides the organisation with options for delivering sustainable annual budgets and affordable Capital Plans over the longer term. It further provides the organisation with a risk assessment of the impact of the options proposed. Therefore, this Local Prudential Code must be prepared to complement the financial strategy.

The overarching principle in the 2012-2015 Financial Strategy is that the Council's resources will be directed to achieving our priorities as set out in the Council Strategic Plan. The key principles underlying the Financial Strategy for 2012-2015 in relation to capital investment, treasury management and risk management are set out below.

Capital Financing and Expenditure

- Capital Investment Strategy reflects Council Strategic Plan priorities and acknowledged available resources;

- A ten-year Capital Plan (including Public Private Partnerships / Private Finance Initiatives (PPP/PFI) arrangements) in place that enhances financial and delivery certainty in relation to infrastructure investment in the borough;

- Capital assets reviewed at least annually to maximise the potential to release value into the business for capital reinvestment;

- Prudential borrowing to support local capital investment priorities or invest to gain schemes that will secure greater revenue efficiencies over the three year financial planning period, in accordance with the Council's Local Prudential Code; and,

- Asset management plans updated on at least an annual basis and acknowledging available budget resources.

Treasury Management

- Treasury Management Strategy with the prime objective being the safeguarding of the Council's assets and a secondary objective being to maximise returns on investments and minimising the costs of borrowing; and,

- Examine strategic options for reducing the overall cost of borrowing despite the increase in the interest rates for the Public Works Loan Board borrowing of 1%.

Risk Management

- Business risk built into all decision-making processes of the Council; and,

- Budget resources aligned to reduce any material financial risks to the Council.

This Local Prudential Code reflects these key principles as set out in the financial strategy. The inclusion of asset sales in the Financial Strategy reflects the affordability of prudential borrowing in terms of the revenue costs impact this will have in future years. Whilst some prudential borrowing may still be considered for local schemes, this should be considered along with the potential sale of assets where appropriate and where it is considered to be value for money.

In addition, alternative methods of generating income should be considered which would have the effect of releasing extra funds for reinvestment in services.

<u>Risk Management</u>

Risk management principles must be included within the capital investment programme. For example, capital investment expenditure is not incurred until sufficient funding is in place. The Council must further incorporate risk management principles within the capital investment programme and include within the 2012-2015 Council Strategic Plan and Budget Setting process.

An assessment must also be made of the likelihood of the risk occurring as high, medium or low and the impact it would have if it were to arise, again indicated as high, medium or low.

With an aim to ensuring that the Capital Plan is sufficiently resourced and fully delivered there is a risk held at Corporate Level to try and make sure controls are in place to manage this.

<u>Key indicators of affordability</u>

The following prudential indicators are key indicators of affordability:

Looking ahead for a three-year period:

- Estimates of the ratio of financing costs to net revenue stream;
- Estimates of the incremental impact of capital investment decisions on the Council Tax / housing rent; and,
- Local indicator for the estimates of the ratio of prudential borrowing to net revenue stream.

After the year end:

- Actual ratio of financing costs to net revenue stream.

The Council must do separate calculations for Housing Revenue Account (HRA) and General Fund elements and for the estimated impact on rents as well as Council Tax. The prudential indicators which look ahead will be calculated and reported to Council as part of the budget setting process each year. A bi-annual update is provided as part of the September Financial Management report to Cabinet. After the year end, calculations must be reported in the Capital Plan outturn report to Cabinet in June each year.

Other prudential indicators that relate to affordability are:

Looking ahead for a three-year period:

- Estimates of capital investment expenditure;
- Estimates of capital financing requirement (underlying need to borrow for a capital purpose);
- Local indicator estimates of capital financing requirement for prudential borrowing;
- Authorised limit for external debt; and,

- Operational boundary for external debt (this is the estimated maximum level of debt of the Council based on the Capital Plan and the Capital Financing Requirement).

After the year end:

- Actual capital investment expenditure;
- Actual capital financing requirement; and,
- Actual external debt.

Both the authorised limit and operational boundary for external debt need to be consistent with the Council's plans for capital investment expenditure and financing; and with its treasury management policy statement and practices. Risk analysis and risk management strategies should also be taken into account.

Prudence

By virtue of the requirements already listed above, the prudential indicators in respect of external debt must be set and revised taking into account their affordability. It is through this means that the objectives of sustainability and prudence are addressed year on year.

In order to ensure that over the medium term net borrowing will only be for a capital investment purpose, the Council 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. This is a key indicator of prudence.

It is also prudent that treasury management is carried out in accordance with good professional practice. The following are required indicators in respect of treasury management:

- Compliance with CIPFA *Treasury Management in the Public Services: Code of Practice and Cross Sectoral Guidance Notes;*
- Upper limits on fixed interest rate and variable interest rate exposures;
- Upper and lower limits for the maturity structure of borrowings; and,
- Upper limit for principal sums invested for periods longer than 364 days.

Decision Making on Capital Investment

A soundly formulated capital investment programme must be driven by the desire to provide high quality, value for money public services.

The Plan demonstrates how the Council will address and meet the needs of the Borough as well as responding to legislative and national policy change and living within its means in terms of the financial (and other) resources available. It also shows how the Council is doing its part to work towards the North Tyneside Strategic Partnership's (NTSP) Sustainable Community Strategy.

The delivery priorities and associated actions will be shaped through the CEI Programme to ensure that there is a single clear picture of the key deliverables across the Council over the period covered by the Council Strategic Plan and Budget. Work has been undertaken to ensure that ongoing actions from the current Council Strategic Plan 2011- 2015 have been reflected as necessary. The key priorities are:

- Supporting people to be healthy and independent and protecting the vulnerable;
- Making change happen, improving customer service and facing up to our financial challenges;
- Delivering sustainable growth;
- Delivering excellent education, skills and employment;
- Protecting and enhancing the environment;
- Creating safe and secure communities; and
- Helping people to make a positive contribution.

This Local Code recognises that in making its capital investment decisions, the Council must have explicit regard to option appraisal, asset management planning, sustainability, capital planning and achievability of the forward plan.

The Council must take a considered approach to whole life costs of assets and services. Such an approach should incorporate the direct and indirect costs of acquiring, running and disposing of assets or resources. In making capital investment decisions the Council must appraise options for their impact on wider social, environmental and economic factors and how these interact to achieve sustainable development. One way of doing this is to apply weightings to qualitative considerations for options appraisal and to considerations that cannot be quantified.

Costs need to be analysed and compared on a regular basis as they are subject to change. They should also be compared over time and the ratio between costs and outputs analysed. Investment decisions need to be based on an analysis of whole life costs and benefits (options are appraised for their impact on the wider social, environmental and economic factors) and how these interact to achieve sustainable development for example, by applying weightings to considerations that cannot be quantified.

All costing information that supports decision-making should include whole life, transaction and unit cost information and show the social and environmental impact of the decision.

All new investments should go through an investment appraisal process which includes evaluation of risks and the relative costs and benefits of the decision.

The Prudential Indicators

This Local Code promotes transparency in decision making by using information contained within the published statements of account of the Council and by having definitions for prudential indicators that are consistent with the definitions used within the statements of account.

Conclusion

The Local Prudential Code supports the system of capital investment in the Council. It is integrated within the wider statutory and management processes of the Council.

A LOCAL PRUDENTIAL CODE FOR NORTH TYNESIDE

Objectives

1. The objective of the Local Code is to provide a framework for the Council's capital finance that will ensure:

    a) Capital investment expenditure plans are *affordable;*

    b) All external borrowing and other long term liabilities are within *prudent and sustainable levels;*

    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 Council is

    d) Accountable, by providing a clear and transparent framework.

Further, the framework established by the Local Code is consistent with and supports:

a) Local capital planning

b) Local asset management planning

c) Proper option appraisal

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

2. A framework for the internal control and self management of capital finance must deal with all three of the following elements:

    a) Capital investment expenditure plans;
    b) External debt; and,
    c) Treasury management

3. The framework to this Local Code includes a set of prudential indicators. These need to be taken together and integrated into a coherent entity, rather than individually.

4. The prudential indicators are designed to support and record local decision making. They are not designed to be comparative performance indicators and the use of them in this way would be likely to be misleading and counter productive.

5. Prudential indicators that are limits are for the determination of the Council subject only to any long stop controls under section 4 of the Local Government Act 2003. A long stop control exists as the Secretary of State may by direction set limits in relation to the borrowing of money by a particular local authority for the purpose of ensuring that the authority does not borrow more than it can afford.

6. The prudential indicators specified in this Code are the minimum currently required to be used by North Tyneside Council. The Council may set further prudential indicators if it wishes.

Scope

7. The Prudential Code applies to all local authorities which, in England and Wales are defined in legislation for the purposes of Part 1 of the Local Government Act 2003.

Process and Governance Issues

Setting and revising prudential indicators

8. Prudential indicators, other than actuals that are taken from information in the Council's statement of accounts, are required to be set and where they are revised, they are to be revised through the process established for the setting and revising of the budget. Therefore, prudential indicators must be set by full Council as part of the Council Strategic Plan and Budget Setting process. Any revisions must be reported through the financial management process.

9. The prudential indicators for the forthcoming and following years must be set before the beginning of the forthcoming year. They may be revised at any time, following due process, as described in (8) above, and must be reviewed, and revised if appropriate, for the current year when the prudential indicators are set for the following year.

10. Provided that the total authorised limit and total operational boundary for external debt for a year are unchanged, movement may be made between separately identified figures within the prudential indicators for borrowing and other long term liabilities by the chief finance officer. Any such changes should be reported to the next meeting of Council.

11. In order to be able to respond to unforeseen and extraordinary circumstances, the prudential indicator for the authorised limit for the time being in force shall be treated as increased where section 5 of the Local Government Act 2003 applies. Any reliance on section 5 to borrow above the authorised limit should be reported to the next meeting of Cabinet.

12. Prudential indicators for treasury management should be considered together with the Council's Treasury Management Strategy and the Annual Report on Treasury Management activities. The Treasury Management Strategy Statement and Annual Investment Strategy should be reported to Cabinet and Council each year as part of the Council Strategic Plan and Budget Setting process and the Annual Treasury Management Report submitted to Cabinet in June.

13. Prudential indicators for external debt for previous years are to be taken directly from information in the Council's Statement of Accounts.

Monitoring against prudential indicators

14. The chief finance officer is required to establish procedures to monitor both performance against all forward looking prudential indicators and the net borrowing and capital financing requirement. The chief finance officer is required to establish a measurement and reporting process that highlights significant deviations from expectations. For this Council these indicators should be monitored half yearly and reported to Cabinet.

Matters required to be taken into account when setting or revising prudential indicators

15. In setting or revising their prudential indicators, the Council is required to have regard to the following matters:

- Affordability, eg implications for Council Tax and Council housing rents;
- Prudence and sustainability, eg implications for external borrowing;
- Value for money, eg options appraisal;
- Stewardship of assets, eg asset management planning;
- Service objectives, eg strategic planning for the authority;
- Practicality, eg achievability of the forward plan; and,
- Risk, e.g. level of acceptability to the authority.

16. The Local Government Act 2003 refers to affordability. In this context, the term affordability has a natural and unrestricted interpretation. The Council must consider the affordability of its capital investment during all the years in which it will have a financial impact on it. Also, in order to ensure long term affordability, decisions have also to be prudent and in the long term sustainable. The Council must also have regard to wider management processes (option appraisal, asset management planning, sustainability, capital planning and achievability) in accordance with good professional practice. The Council is also required to take into account Private Finance Initiative projects in setting or revising its prudential indicators.

17. The prudential indicators provide a broad framework to be considered alongside robust forecasting procedures embedded into the Council Strategic Plan and Budget Setting process. Forecasts should be regularly updated as the capital investment programme develops, and proposals should be considered in terms of their impact on the overall corporate position. Integration of these features into the financial processes ensures that prudence and affordability are taken into account.

Affordability and prudential indicators for affordability

18. The fundamental objective in the consideration of the affordability of the Council's Capital Plans is to ensure that the level of investment in capital assets proposed means that the total capital investment of the Council remains within sustainable limits, and in particular to consider its impact on the Council's 'bottom line' Council Tax. Affordability is ultimately determined by a judgement about acceptable Council

Tax levels and, in the case of the Housing Revenue Account, acceptable rent levels.

19. In considering the affordability of its Capital Plans, the Council is required to consider all of the resources currently available to it / estimated for the future, together with the totality of its Capital Plans, revenue income and revenue expenditure forecasts for the forthcoming year and the following two years. The Council is also required to consider known significant variations beyond this timeframe.

20. The Council shall set and monitor against the prudential indicators specified below as key indicators of affordability. These prudential indicators shall be set and monitored in accordance with this section, with all the matters to be taken into account (as specified in the section above) with the due processes to be followed (as specified above).

21. Estimates of ratio of financing costs to net revenue stream:

The Net Revenue Stream is the amount to be met from government grants and local taxpayers.

a) The Council will estimate for the forthcoming financial year and the following two financial years the ratio of financing costs to net revenue stream. This prudential indicator shall be referred to as estimates of the ratio of financing costs to net revenue stream and shall be expressed in the following manner:

Estimate of financing costs / estimate of net revenue stream X 100%

This is calculated for years 1,2 and 3.

b) The Council will estimate for the forthcoming financial year and the following two financial years the ratio of financing costs relating to prudential borrowing to net revenue stream. This local prudential indicator shall be referred to as estimates of the ratio of financing costs relating to prudential borrowing to net revenue stream and shall be expressed in the following manner:

Estimate of financing costs for prudential borrowing / estimate of net revenue stream X 100%

This is calculated for years 1,2 and 3.

22. As the Council has a Housing Revenue Account (HRA), it must identify separately estimates of the ratio of the HRA financing costs to the HRA net revenue stream and estimates of the ratio of the non-HRA financing costs to the non-HRA net revenue stream. The separation between the HRA and non-HRA elements of these prudential indicators will be taken as determined under legislation. The estimates of HRA and non-HRA capital financing costs will, taken together, sum to the total

estimates of the capital financing costs. The local indicator would also be split between HRA and non HRA elements.

23. Actual ratio of financing costs to net revenue stream:

    c) After the year end, the ratio of financing costs to net revenue stream will be calculated directly from the Council's consolidated revenue account. This prudential indicator shall be referred to as actual ratio of financing costs to net revenue stream and shall be expressed in the following manner:

Actual financing costs / actual net revenue stream X 100%

24. As the Council has a Housing Revenue Account (HRA), it must identify separately the actual ratio of the HRA financing costs to the HRA net revenue stream and the actual ratio of the non-HRA financing costs to the non-HRA net revenue stream. The separation between the HRA and non-HRA elements of these prudential indicators will be taken as determined under legislation. The actuals of HRA and non-HRA capital financing costs will, taken together, sum to the total actuals of the capital financing costs.

25. Estimates of the incremental impact of capital investment decisions on the Council Tax. The Council will:

    - Forecast the total budgetary requirements for the Council based on no changes to the existing capital investment programme;
    - Forecast the total budgetary requirements for the Council with the changes proposed to the capital investment programme included in the calculation;
    - Take the difference between the two calculations above and calculate the addition or reduction to Council Tax that would result.

    This calculation must be undertaken for the forthcoming year and the following two financial years or longer timeframe if required to capture the full year effect of capital investment decisions. This prudential indicator will be referred to as estimates of the incremental impact of the new capital investment decisions on the Council Tax and shall be expressed in the following manner:

£xx.xx

26. Estimates of the incremental impact of capital investment decisions on housing rents:

As the Council has a HRA it must perform the calculation described in paragraph 25 above split between HRA and non-HRA elements.

Prudence and prudential indicators for prudence

27. By virtue of the requirements already listed above, the prudential indicators in respect of external debt must be set and revised taking into account their affordability. It is through this means that the objective of ensuring that external debt is kept within sustainable, prudent limits is addressed year on year.

28. Net borrowing and the capital financing requirement.

In order to ensure that over the medium term net borrowing will only be for a capital purpose, the Council 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. This is a key indicator of prudence. This prudential indicator will be referred to as net borrowing and the capital financing requirement.

29. Ensuring that treasury management is carried out in accordance with good professional practice is an essential feature of prudence. The prudential indicators on treasury management, specified later in this Local Code are designed to help demonstrate compliance in this regard.

Prudential indicators for Capital Expenditure, External Debt and Treasury Management

30. The Council will set and monitor against the specified prudential indicators for capital investment expenditure, external debt and treasury management, as set out below, in accordance with due processes to be followed (as specified in the section above), the matters to be taken into account (as specified in the section above), affordability (as specified above), and prudence (as specified above).

Capital Expenditure

31. Estimates of capital expenditure

The Council will make reasonable estimates of the total of capital expenditure that it plans to incur during the forthcoming financial year and at least the following two financial years. These prudential indicators will be referred to as estimates of capital expenditure and shall be expressed in the following manner:

Estimate of total capital expenditure to be incurred in years 1,2 and 3.

32. As the Council has a Housing Revenue Account (HRA), estimates of HRA capital expenditure and estimates of non-HRA capital expenditure need to be identified separately. The separation between the HRA and non-HRA elements of these prudential indicators will be undertaken as determined under legislation. The

estimates of HRA and non-HRA capital expenditure will, taken together, sum to the total estimates of capital expenditure.

33. Actual capital expenditure

After the year end, the actual capital expenditure incurred during the financial year will be recorded. This prudential indicator will be referred to as actual capital expenditure and shall be expressed as follows:

Actual capital investment expenditure for 20xx/20xx

34. As the Council has a Housing Revenue Account (HRA), actual HRA capital investment expenditure and actual non-HRA capital investment expenditure need to be identified separately. The separation between the HRA and non-HRA elements of these prudential indicators will be undertaken as determined under legislation. The actual HRA and non-HRA capital investment expenditure will, taken together, sum to the total actual capital investment expenditure.

35. Estimates of capital financing requirement

a) The Council will make reasonable estimates of the total capital financing requirement at the end of the forthcoming financial year and the following two years. These prudential indicators will be referred to as the estimates of capital financing requirement and shall be expressed as follows:

Estimate of capital financing requirement as at the end of years 1,2 and 3.

b) The Council will make reasonable estimates of the total capital financing requirement for unsupported (prudential) borrowing at the end of the forthcoming financial year and the following two years. These local prudential indicators will be referred to as the estimates of capital financing requirement for unsupported (prudential) borrowing and shall be expressed as follows:

Estimate of capital financing requirement for unsupported (prudential) borrowing as at the end of years 1,2 and 3.

36. As the Council has a Housing Revenue Account (HRA), estimates of the HRA capital financing requirement and estimates of the non-HRA capital financing requirement need to be identified separately. The separation between the HRA and non-HRA elements of these prudential indicators will be undertaken as determined under legislation. The estimates of HRA and non-HRA capital financing requirement will, taken together, sum to the total estimates of the capital financing requirement. The local indicator would also be split between the HRA and non HRA elements.

37. In order to make these estimates, the Council will need to consider all of the financing options available and estimate its use of these. The estimates will not commit the Council to particular methods of financing. The chief finance officer will determine the actual financing of capital investment expenditure incurred once a year, after the end of the financial year. This will be included in the Finance Outturn report to Cabinet in June each year.

Actual capital financing requirement

38. After the year end, the actual capital financing requirement will be calculated directly from the Council's balance sheet. This prudential indicator will be referred to as the actual capital financing requirement and will be expressed as follows:

Actual capital financing requirement as at 31/03/xx

39. As the Council has a Housing Revenue Account (HRA), actual HRA capital financing requirement and the actual non-HRA capital financing requirement need to be identified separately. The separation between the HRA and non-HRA elements of these prudential indicators will be undertaken as determined under legislation. The actual HRA and non-HRA capital financing requirement will, taken together, sum to the total actual capital financing requirement.

External Debt

40. Authorised limit

It is the statutory duty of a local authority under section 3 of the Local Government Act 2003 for the Council to determine and keep under review how much it can afford to borrow. This is laid down in the Treasury Management Strategy.

The Council will set for the forthcoming financial year and the following two financial years an authorised limit for its total external debt, gross of investments, separately identifying borrowing from other long term liabilities. This prudential indicator will be referred to as the authorised limit and shall be expressed in the following manner:

Authorised limit for external debt = authorised limit for borrowing + authorised limit for other long term liabilities.

41. Operational boundary

The proposed Operational Boundary for external debt is based on the same estimates as the Authorised Limit but reflects directly the chief finance officer's estimate of the most likely, prudent but not worst case scenario, 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 by the chief finance officer. Within the Operational Boundary, figures for borrowing and other long-term liabilities are separately identified. Council is requested to delegate authority to the chief finance officer, 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 Council will also set for the forthcoming financial year and the following two financial years an operational boundary for its total external debt, gross of investments, separately identifying borrowing from other long term liabilities. This prudential indicator will be referred to as the operational boundary and will be expressed in the following manner:

Operational boundary for external debt = operational boundary for borrowing + operational boundary for other long term liabilities. Calculated for years 1,2 and 3.

42. Both the authorised limit and operational boundary need to be consistent with our plans for capital investment expenditure and financing (as determined by the Capital Plan which is approved as part of the Council Strategic Plan and Budget Setting process); and with our treasury management policy statement and practices.

43. The operational boundary will be based on the Council's estimate of most likely, ie prudent, but not worst case scenario. Risk analysis and risk management strategies need to be taken into account. The operational boundary must equate to the maximum level of external debt projected by this estimate.

Actual external debt

44. After the year end, the closing balance for actual gross borrowing plus (separately) other long term liabilities will be obtained directly from the Council's balance sheet. This prudential indicator will be referred to as actual external debt and shall be expressed in the following manner:

Actual external debt as at 31/03/xx = actual borrowing as at 31/03/xx + actual other long term liabilities as at 31/03/xx.

45. The prudential indicator for actual external debt will not be directly comparable to the authorised limit and operational boundary, since the actual external debt will reflect the actual position at one point in time.

Treasury Management

46. The first prudential indicator in respect of treasury management is that the Council must have adopted the CIPFA Code *for Treasury Management in the Public Services: Code of Practice and Cross Sectoral Guidance Notes.*

47. Interest rate exposures

The Council will set for the forthcoming financial year and the following two financial years upper limits to its exposures to the effects of changes in interest rates. These prudential indicators will relate to both fixed interest rates and variable interest rates and will be referred to respectively as the upper limits on fixed interest rate and variable interest rate exposures.

48. The upper limits on fixed interest rate and variable interest rate exposures may be expressed either as absolute amounts or as percentages. They may be related either to the Council's net interest on, or to its net principal sum outstanding on, its borrowing / investments.

49. The upper limit on fixed interest rate exposures will be calculated as follows:

Either:
Interest payable on borrowing at fixed rates
Less
Interest receivable on investments that are fixed rate investments
For years 1,2 and 3.
Or:
Principal sums outstanding in respect of borrowing at fixed rates
Less
Principal sums outstanding in respect of investments that are fixed rate investments
For years 1,2 and 3.

50. The upper limit on variable interest rate exposures will be calculated as for fixed interest rate exposures, but substituting 'variable rates' for 'fixed rates'.

51. In cases where the terms of the borrowing or investment raise questions as to whether it should be treated as fixed or variable, it should be treated as being variable for the purposes of these prudential indicators.

52. The effect of setting these upper limits is to provide ranges within which we will manage our exposure to fixed and variable rates of interest.

53. Maturity structure of borrowing

The Council will set for the forthcoming financial year both upper and lower limits with respect to the maturity structure of its borrowing. These prudential indicators will be referred to as the upper and lower limits respectively for the maturity structure of borrowing and will be calculated 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

Where the periods in question are • under 12 months • 12 months and within 24 months • 24 months and within 5 years • 5 years and within 10 years • 10 years and above

The maturity of borrowing will be determined by reference to the earliest date on which the lender can require payment.

55. Revisions to limits on interest rate exposures and maturity structure of borrowing.

    Where prudential indicators for interest rate exposures and / or the maturity structure of borrowing are revised during the financial year, the time periods under 12 months / 12 months and within 24 months, etc shall refer to the time periods within 12 months of the start of the financial year (1 April in the relevant year) / from 12 months and within 24 months, etc respectively.

56. Total principal sums invested for periods longer than 364 days

    Where the Council invests, or plans to invest, for periods longer than 364 days, the Council will set an upper limit for each forward financial year period for the maturing of such investments. These prudential indicators will be referred to as prudential limits for principal sums invested for periods longer than 364 days and will be calculated as follows:

Total principal sum invested to final maturities beyond the period end

Calculated for years 1,2,3 etc

57. The purpose of the prudential limits for principal sums invested for periods longer than 364 days is for the Council to contain its exposure to the possibility of loss that might arise as a result of it having to seek early repayment or redemption of principal sums invested.

58. For the Council, the process of setting prudential indicators for treasury management will be led by a clear and integrated forward treasury management strategy, and a recognition of the pre-existing structure of the Councils borrowing and investment portfolios.

59. The Council should bear in mind that prime policy objectives of their investment activities are to encourage safety and liquidity, and to avoid exposing public funds to unnecessary or unquantified risk. The pursuit of optimum performance from the investment of legitimate surplus funds, as a secondary policy objective, is a best practice approach to treasury management and is to be encouraged. The Council must not borrow more than or in advance of their needs purely in order to profit from

the investment of the extra sums borrowed. Freedoms to invest longer term or in investment instruments will therefore be used always with these principals in mind.

Glossary of Terms

CIPFA – Chartered Institute of Public Finance and Accountancy

Capital Financing – The resources required to fund capital payments eg, borrowing, the application of useable capital receipts; a direct charge to revenue; or, the application of a capital grant.

External debt – All borrowing, whether for capital or revenue purposes

Borrowing – Refers to external borrowing

Capital Investment Expenditure – The total amount spent on capital including all those items capitalised under CIPFA Code of Practice on Local Authority Accounting eg, equal pay, redundancies and grants to third parties.

Long Stop Control - The Secretary of State may by direction set limits in relation to the borrowing of money by a particular local authority for the purpose of ensuring that the authority does not borrow more than it can afford.

Debt – The sum of borrowing and other long term liabilities

Net Revenue Stream – This is the net revenue budget.

Other Long Term Liabilities – The sum of the amounts on the face of the balance sheet that are classified as liabilities that are for periods in excess of 12 months, other than borrowing repayable within a period in excess of 12 months eg, PFI, finance leases and Longbenton transferred debt.

PFI – Private Finance Initiative

Treasury Management – The management of the organisations cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks.

Authorised Limit – This is the maximum limit for debt and it must not be breached without Council approval. It allows headroom for unusual temporary cashflow positions eg, debt restructuring. The limit may be reached on occasion but not on a regular basis.

Operational Boundary – This is the most likely, prudent view of the level of gross external indebtedness. External debt includes both borrowing and long term liabilities (e.g. finance leases), with separate boundaries having to be identified for each of these. It encompasses all borrowing, whether for capital or revenue purposes.

Capital Financing Requirement – This is the amount required to finance capital expenditure. It also includes all past expenditure financed by borrowing. The amount is reduced each year by the Minimum Revenue Provision (MRP) (Principal repayment) and increased by any unsupported (prudential) borrowing undertaken during the year.