AGENDA ITEM NO 6(c)

Report 64/15

ANGUS COUNCIL

Special Budget Meeting of Angus Council – 12 February 2015

Setting of Prudential Indicators for 2015/16 Budget Process

Report by the Head of Corporate Improvement & Finance

ABSTRACT
The purpose of this report is to advise members of the Prudential Indicators which the Council is required to consider and approve as part of the budget setting process.

1 RECOMMENDATIONS

It is recommended that the Council:

(i) Note the purpose of the Prudential Code and the Prudential Indicators which require to be set as outlined in the report.

(ii) Note those Prudential Indicators set out in sections 6 to 10 of the report which are based on 2013/14 actual information.

(iii) Approve the Prudential Indicators and narrative relating to financial years 2015/16 to 2018/19 as set out in sections 6 to 10 (tables 1 to 6) of the report in compliance with the Prudential Code requirements.

(iv) Note the prudential indicator monitoring information provided in **Appendix A**.

2 ALIGNMENT TO ANGUS COMMUNITY PLAN / SINGLE OUTCOME AGREEMENT

The projects undertaken through the Council's capital programme contribute as a whole to the local outcomes contained within the Angus Community Plan and Single Outcome Agreement 2013-2016.

3 BACKGROUND

The 2015/16 capital budget has been prepared by Angus Council under the self regulating Prudential Code for Capital Finance in Local Authorities (2011 Edition). Local authorities are required by regulation to comply with the Prudential Code in terms of meeting their statutory duty under Section 35(1) of the Local Government in Scotland Act 2003 to *"determine and keep under review the maximum amount which it can afford to allocate to capital expenditure"*).

The key objectives of the Prudential Code are to ensure that the capital investment plans of local authorities are affordable, prudent and sustainable, as well as being consistent with and supporting local strategic planning, local asset management planning and proper option appraisal. To demonstrate that local authorities have fulfilled these objectives, the Prudential Code sets out a number of Prudential Indicators that must be considered covering 5 distinct areas – capital expenditure, affordability, prudence, external debt and treasury management.

The key indicators that drive the capital budget decision making process continue to be those concerning affordability, as these measure the impact of capital investment decisions on the overall revenue budget and in particular the Council Tax.

For further background on the Prudential Code, Members are referred to reports 727/03 and 997/03 to the Resources & Central Services Committee which outlined the changes to the system of central government controls on local authority capital expenditure which took effect from 1 April 2004. The reports are available on the Council intranet.

The remainder of this report covers each of the Prudential Indicators which require to be set in turn. A brief description of each indicator and its purpose is provided.

4 BASE INFORMATION & RISK ISSUES

The Council is advised that the Prudential Indicators shown in Sections 6 to 10 below have been determined based on the budget proposals contained in the Provisional Revenue Budget and Savings Proposals Volume 2015/16 (report 60/15) and the 2014/2019 Financial Plan and 2015/16 Provisional Capital Budget Volume (report 61/15). The 2014/2019 Financial Plan covers the five financial years 2014/15 to 2018/19. A number of the indicators presented in this report are calculated for six financial years in total – the 2013/14 actual year end position, latest estimates for 2014/15 and estimates for the 4 years 2015/16 to 2018/19. **The indicators which the Council is being asked to formally approve are those relating to financial years 2015/16, 2016/17, 2017/18 and 2018/19, as detailed in tables 1 to 6 contained in this report**.

<u>In particular Members are asked to note that proposals which would alter the capital financing costs allowance in the 2015/16 Provisional Revenue Budget, the currently estimated levels for 2016/17 to 2018/19 or the proposed capital budgets for 2015/16 to 2018/19 could impact on the Prudential Indicators to be set.</u>

The Council will be well aware that in setting any budget there is a degree of uncertainty and risk involved. The Prudential Indicators set out in this report are based on the best information available from the Council's intended and projected budgets. Specific comment on any particular risks to be borne in mind is provided where relevant under each of the indicators.

The Prudential Indicators for the HRA have been reported and considered separately as part of the rent setting process (report 53/15 refers). Members are asked to note however that for some of the treasury management indicators it is not possible to distinguish between General Fund and the Housing Revenue Account and that some of these indicators also include debt relating to the former Tayside Police. Whilst Angus Council is no longer liable for any costs associated with the police debt it continues to manage this debt on behalf of Police Scotland.

5 PRUDENTIAL INDICATORS - INTRODUCTION

It is important to view the indicators in sections 6 to 10 of this report as a comprehensive and inter-related package which is intended to demonstrate that the Council's capital investment plans are prudent, affordable and sustainable. It is emphasised that it is for the Council to set its own Prudential Indicators and in this sense there is no right or wrong answer to be reached for each indicator.

<u>PPP / PFI Projects</u>

Members are asked to note that a number of indicators are impacted by specific International Financial Reporting Standards relating to PPP / PFI projects. These standards brought about a change in the accounting treatment of the Council's PPP / PFI projects (namely the A92, Beech Hill House and Forfar / Carnoustie Schools) whereby they are now included on the Council's balance sheet. Notwithstanding that they have been carried out with private finance with Unitary Charges paid from the revenue budget, in line with the latest version of the Prudential Code (2011 Edition), they are considered capital in nature and therefore are taken into account for indicators which have a capital connection.

<u>Scottish Futures Trust - Brechin and Forfar Community Campus Projects</u>

Report 624/13 to the Education committee of 21 November 2013 provided details of changes to the funding of the Council's community campus projects in Brechin and Forfar. The direct capital implications of these funding changes are reflected in the 2014/2019 Financial Plan and are therefore automatically built into the prudential indicators calculated in this report. Forfar Academy Community Campus will now be built using private finance with Unitary Charges paid from the revenue budget and is therefore not automatically reflected in the prudential indicators. As with the PPP / PFI projects however, it is still considered capital in nature and has therefore been taken into account for indicators with a capital connection.

6 PRUDENTIAL INDICATORS FOR CAPITAL EXPENDITURE

6.1 Estimates Of Gross Capital Expenditure

The Prudential Code requires the Council to make reasonable estimates of the total capital expenditure that it plans to incur during the forthcoming financial year and, at minimum, the following two financial years. In addition to these forward year estimates of capital expenditure the Prudential Code also requires councils to note the actual capital expenditure for the most recently completed financial year.

Table 1 – Prudential Indicators for Actual and Estimated Capital Expenditure

	Actual 2013/14 £m	Estimate 2014/15 £m	Estimate 2015/16 £m	Estimate 2016/17 £m	Estimate 2017/18 £m	Estimate 2018/19 £m
Net Expenditure	n/a	31.091	45.757	21.369	15.615	9.060
Add: Contingency	n/a	0.000	1.000	1.000	1.000	4.000
Remove: Oversubscription	n/a	0.000	(3.406)	(3.406)	(3.633)	(0.908)
Add: Receipts / Contributions Netted Off within Financial Plan	n/a	7.037	3.579	2.641	1.659	2.357
Gross Capital Expenditure	20.780	38.128	46.930	21.604	14.641	14.509

As noted earlier at Section 3 of this report, councils are required to "*determine and keep under review the maximum amount which it can afford to allocate to capital expenditure*". The amount so determined is termed the "Affordable Capital Expenditure Limit" and members are asked to note that the estimates of gross capital expenditure proposed in Table 1 represent Angus Council's affordable capital expenditure limits for the four forward years (2015/16 to 2018/19).

The above figures show some significant movements between years both on a gross and net capital expenditure basis. The main cause of this is the value of the capital projects which are undertaken in any particular year – this is particularly evident in 2014/15 and 2015/16 when the bulk of the capital expenditure on Brechin High School Community Campus and Arbroath Primary Schools (Phase 1) is anticipated to be incurred.

6.2 Estimates of Capital Financing Requirement

Angus Council has available to it a number of ways of financing the capital expenditure proposed in Table 1, above. A number of these financing options involve resourcing the investment at the time at which it is incurred, namely:

(i) the application of useable capital receipts;
(ii) a direct charge to revenue for the capital expenditure (CFCR);
(iii) the application of capital grants and contributions; and
(iv) securing an upfront contribution from another party towards the cost of a project.

Capital expenditure that is not financed upfront by one of these methods will increase the capital financing requirement of the Council. The calculation of the capital financing requirement is therefore intended to reflect the Council's underlying need to borrow for a capital purpose and it is used as a key measure in treasury management decisions for this reason.

In accordance with best professional practice the Council does not associate borrowing with particular items or types of expenditure. The Council manages its borrowings and investments in accordance with approved treasury management policy which means that in day to day cash management no distinction can be made between revenue cash and capital cash. External borrowing arises as a consequence of all the financial transactions of the Council and not simply those arising from capital spending. In contrast the capital financing requirement reflects the Council's underlying need to borrow for a capital purpose.

The Prudential Code requires that the capital financing requirement is estimated for the end of the forthcoming financial year and, at minimum, the following two years. The Council is also required to note the actual capital financing requirement for the most recently completed financial year. The estimated capital financing requirement at each year end will reflect all capital expenditure – i.e. it includes relevant capital expenditure incurred in previous years.

Table 2 – Prudential Indicators for Actual and Estimated Capital Financing Requirement

Actual as at 31/03/14 £m	Estimate as at 31/03/15 £m	Estimate as at 31/03/16 £m	Estimate as at 31/03/17 £m	Estimate as at 31/03/18 £m	Estimate as at 31/03/19 £m
212.123	214.982	220.842	221.919	250.893	241.495

7 PRUDENTIAL INDICATORS FOR AFFORDABILITY

7.1 Relationship Between Capital And Revenue Expenditure

The Prudential Indicators for affordability are considered to be the most important within the Prudential Code because they effectively capture the bottom line revenue impact of capital spending decisions. In this regard it is important to appreciate the relationship between capital and revenue expenditure.

Capital expenditure which is not funded by capital grants and contributions, capital receipts or directly from the revenue budget (as Capital Funded from Current Revenue - CFCR) will involve borrowing via the Council’s loans fund. This borrowing carries with it a requirement to repay the amount borrowed (the principal); the interest charges incurred thereon; and a share of loans fund expenses. The principal repayment, interest and expenses charges are collectively referred to as capital financing costs (sometimes also called loan charges). Capital financing costs need to be paid for through the Council’s revenue budget. Other forms of financing costs which require to be paid for through the revenue budget are those associated with finance leases, PPP / PFI liabilities and projects with similar private finance arrangements (e.g. Forfar Community Campus).

The Prudential Indicators on affordability are intended to ensure that the revenue budget impact of capital spending decisions are shown on a transparent basis which demonstrates that such capital spending decisions are affordable both now and into the future. Report 63/15 on the long term affordability of the General Fund Financial Plan takes the assessment of affordability beyond the minimum requirements of the Prudential Code.

7.2 Estimates Of Ratio Of Financing Costs To Net Revenue Stream

This indicator is intended to measure the percentage of the Council’s total income that it is estimated will be committed towards meeting the costs of the borrowing and other credit arrangements used to fund capital expenditure. In simple terms the more of the Council’s total income that is needed to fund financing costs the less is available to meet other revenue expenditure such as salaries, supplies, etc. There is however no right answer as to what the ratio of financing costs to net revenue stream should be.

The Prudential Code requires the Council to make estimates of the ratio of financing costs to its net revenue stream for the forthcoming financial year and, at minimum, the following two financial years. The Council is also required to note the actual ratio of financing costs to net revenue stream for the most recently completed financial year.

Table 3 – Prudential Indicators for Actual and Estimated Ratio of Financing Costs to Net Revenue Stream

Actual 2013/14	Estimate 2014/15	Estimate 2015/16	Estimate 2016/17	Estimate 2017/18	Estimate 2018/19
9.45%	8.69%	9.35%	9.67%	9.94%	10.11%

It may be noted from the above table that from 2014/15 onwards the ratio of financing costs to net revenue stream is anticipated to marginally increase year on year. In simple terms, this means that the percentage of the Council’s income which will be utilised to fund capital expenditure financing costs will rise each year.

For the purpose of calculating these indicators, it has been necessary to make assumptions with regard to levels of revenue income and expenditure for 2016/17 to 2018/19 – this has been done on the basis of known movements in revenue funding, as announced through the recent Finance Settlement.

7.3 Estimates Of The Incremental Impact Of Capital Investment Decisions On The Council Tax

This indicator is intended to measure the incremental impact on the Council Tax which would arise from changes to the Council's existing capital budget.

The capital financing cost consequences of the capital budget proposals contained within the 2014/2019 Financial Plan and 2015/16 Provisional Capital Budget (report 61/15) have been assessed as part of the long term affordability strategy (report 63/15). The resulting capital financing costs have been compared with the provision for these costs in the Council's 2015/16 Provisional Revenue Budget and Savings Proposals Volume (report 60/15) and the currently estimated levels for 2016/17 onwards. This analysis indicates that the capital financing cost consequences of the capital budget proposals contained in report 61/15, which covers the period to 2018/19, will be contained within the provision for such costs within the proposed / projected budgets for those years.

The Code requires the Council to isolate the growth in the latest capital programme from that previously approved. The revision to the Council's Financial Plan (per report 61/15) from that previously approved and reported in the Final Capital Budget Volume has been assessed in line with the requirements of the Code. For financial years 2015/16 to 2018/19, the capital financing costs consequences arising from the proposed capital programme have been assessed and compared to the revenue resources set aside to meet these costs (as detailed in the long term affordability strategy contained in report 63/15).

In summary, the capital expenditure proposals contained within report 61/15 are considered to be affordable without requiring any specific additional increase in the Council Tax in these years.

In arriving at the above assessment, members are asked to note that it has been assumed that in the short term, the Council's loans fund interest rate will not be materially affected by fluctuations in market interest rates.

Table 4 – Estimates of the Incremental Impact of Capital Investment Decisions on the Council Tax

Estimate 2015/16	Estimate 2016/17	Estimate 2017/18	Estimate 2018/19
£nil	£nil	£nil	£nil

8 PRUDENTIAL INDICATORS FOR PRUDENCE

8.1 Gross Borrowing And The Capital Financing Requirement

As part of the Prudential Code the Council must undertake a cross check of how its gross borrowing compares with its capital financing requirement. The Council's capital financing requirement exceeding its gross external borrowing position is a demonstration of a prudent capital investment strategy. This Prudential Indicator is intended to ensure that over the medium term borrowing incurred by the Council will only be used for capital purposes.

The Council is required to ensure that gross borrowing does not, except in the short term, exceed the total capital financing requirement in the preceding year plus estimates of any additional capital financing requirement for the current and, at minimum, the next two financial years.

Members are asked to note that analysis undertaken by the Head of Corporate Improvement & Finance shows that the Council will have no difficulty in meeting this requirement in 2015/16, nor are any difficulties envisaged for the current or future years. This view takes into account current commitments, existing plans and the proposals in the revenue and capital budgets (reports 60/15 and 61/15 refer).

It should be noted that in the above assessment of Capital Financing Requirement (CFR) versus gross borrowing the calculations include both General Fund and HRA. The Council's gross external borrowing cannot be broken down between General Fund and the HRA. Accordingly for comparative purposes the total CFR for the Council has been used.

9 PRUDENTIAL INDICATORS FOR EXTERNAL DEBT

9.1 Authorised Limit

The Prudential Code requires the Council to set an authorised limit for its total external debt. In this context total external debt needs to be expressed as gross of investments and split between borrowing and other long term liabilities (such as finance leases held by the Council and the liabilities associated with the Council's PPP / PFI projects).

Based on the Council's plans for capital expenditure and financing, the authorised limit represents a maximum value beyond which the Council's total external debt must not exceed. This indicator is intended as a backstop control mechanism over the Council's external debt position and is based on possible rather than probable events. A comparison of the Council's actual external debt and the authorised limit will be made on a regular basis as part of the Corporate Improvement & Finance Division's Treasury Management activities.

An authorised limit needs to be set for the forthcoming financial year and, at minimum, the following two financial years.

The estimates of what the Head Corporate Improvement & Finance considers would be a reasonable authorised limit for the Council to set for the four forward years (2015/16, 2016/17, 2017/18 and 2018/19) which are recommended for approval are shown in Table 5 below. The estimated equivalent figure for the current year (2014/15) is shown for comparative / information purposes. The recommended limits are consistent with the Council's current commitments, existing plans and the proposals contained within the budget reports (60/15 and 61/15). This indicator is a Council wide indicator so there is no separation between General Fund and the HRA.

Table 5 – Authorised Limits

Commitment	2014/15 £m	2015/16 £m	2016/17 £m	2017/18 £m	2018/19 £m
Borrowing	220.000	220.000	220.000	220.000	220.000
Finance Lease Liabilities	0.434	0.414	0.394	0.372	0.349
PPP / PFI Liabilities	86.000	84.000	82.000	80.000	77.000
East Central Territory Hubco Liability	0.000	0.000	0.000	36.897	36.428
Total – Authorised Limit for External Debt	306.434	304.414	302.394	337.269	333.777

The overall authorised limit rises significantly in 2017/18 to accommodate the East Central Territory Hubco liability incurred in relation to Forfar Academy Community Campus.

Members are asked to note that although this indicator represents a maximum to which the Council could potentially borrow, in practical terms the Council will operate within the borrowing element only in this regard.

9.2 Operational Boundary

This Prudential Indicator is the focus of day to day treasury management activity within the Council. It is a means by which the Council will ensure that it remains within the self-imposed authorised limit (section 9.1 above). It differs from the authorised limit in that it is based on expectations of the maximum external debt of Angus Council according to probable – as opposed to possible – events and should be in line with the maximum level of external debt projected by the estimates. In this context total external debt needs to be expressed as gross of investments and split between borrowing and other long term liabilities. As with the authorised limit, above, the liabilities associated with the Council's finance leases and PPP / PFI projects are also included.

Unlike the authorised limit an occasional breach of the operational boundary on a temporary basis should not be regarded as a significant problem, merely a situation which reflects the peaks and troughs nature of the Council's cashflow. An ongoing breach caused by borrowing activity as part of a debt rescheduling exercise should also be regarded as acceptable, albeit this will require specific monitoring by Treasury Management staff. Any ongoing or regular breach of the operational boundary not due to the aforementioned factors would however require investigation.

It will then be the responsibility of the Head of Corporate Improvement & Finance to determine if it would be prudent to raise the current boundary or, alternatively, to instigate procedures to ensure that limits are not breached.

The Prudential Code requires that an operational boundary be set for the forthcoming financial year and, at minimum, the following two financial years.

The estimates of what the Head of Corporate Improvement & Finance considers would be a reasonable operational limit for the Council to set for the four forward years (2015/16, 2016/17, 2017/18 and 2018/19) which are recommended for approval are shown in Table 6 below. The estimated equivalent figure for the current year (2014/15) is shown for comparative / information purposes. The recommended limits are consistent with the Council's current commitments, existing plans and the proposals contained within the budget reports (60/15 and 61/15). This indicator is a Council wide indicator so there is no separation between General Fund and the HRA.

Table 6 – Operational Boundary

Commitment	2014/15 £m	2015/16 £m	2016/17 £m	2017/18 £m	2018/19 £m
Borrowing	205.000	205.000	205.000	205.000	205.000
Finance Lease Liabilities	0.434	0.414	0.394	0.372	0.349
PPP / PFI Liabilities	86.000	84.000	82.000	80.000	77.000
East Central Territory Hubco Liability	0.000	0.000	0.000	36.897	36.428
Total – Operational Boundary for External Debt	291.434	289.414	287.394	322.269	318.777

As with the authorised limit, the overall operational boundary rises significantly in 2017/18 to accommodate the East Central Territory Hubco liability incurred in relation to Forfar Academy Community Campus.

Members are asked to note that although this indicator represents the operational level within which the Council could potentially borrow, in practical terms the Council will operate within the borrowing element only in this regard.

9.3 Actual External Debt

During the course of the year, actual external debt requires to be monitored on a basis that reflects the circumstances and management arrangements of the Council. A daily record of the Council's actual external debt is kept as part of the Corporate Improvement & Finance Division's Treasury Management activities.

The Code requires the Council to note what its actual external debt position was at the end of the latest completed financial year.

Angus Council's actual external debt as at 31 March 2014 was £251.177 million, comprising of:

Liability	£m
Borrowing	163.480
Finance Leases	0.453
PPP / PFI Liability	87.244
Total	251.177

Members are asked to note that the actual external debt reflects the position at a particular point in time and is therefore not directly comparable to the authorised limit and operational boundary.

10 PRUDENTIAL INDICATORS FOR TREASURY MANAGEMENT

It is a requirement of the Prudential Code that local authorities adopt the CIPFA Code of Practice for Treasury Management in the Public Services.

The latest version of the Code of Practice for Treasury Management (2009) was formally adopted by Angus Council at its meeting of 25 March 2010 (report 244/10 refers) and was updated in 2011. No formal adoption of the revised version was required and the 2011 edition has been followed in preparing this report.

11 PRUDENTIAL INDICATORS – CONCLUSION

The Prudential Indicators laid out in Sections 6 to 10 above are considered to provide the Council with a robust framework and reflect a capital investment strategy which is prudent, affordable and sustainable. Members of the Council are asked to consider the indicators both individually and collectively and decide whether they consider the proposals to be prudent, affordable and sustainable.

In this regard, reference should also be made to report 63/15 concerning the long-term affordability of the General Fund Financial Plan.

12 PRUDENTIAL INDICATOR MONITORING

The Prudential Code requires the Chief Finance Officer to "establish procedures to monitor both performance against all forward looking prudential indicators and the requirement specified in paragraph 45" (ensuring that treasury management is carried out in accordance with good professional practice). Each of the Prudential Indicators required by the Code has been reviewed and a conclusion reached on the monitoring procedures to be applied. The monitoring requirements of the Code will accordingly be picked up through each year's prudential indicator setting report, as well as within the 2015/16 Final Capital Budget Volume and through the operation of the daily treasury management activity.

Appendix A to this report provides members with additional monitoring information in relation to the Prudential Indicators set in February 2014.

13 FINANCIAL IMPLICATIONS

There are no specific financial implications associated with this report which have not been explained in the main body of the report.

NOTE: No background papers, as defined by Section 50D of the Local Government (Scotland) Act 1973, were used in the preparation of this report.

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List of Appendices:

Appendix A – Prudential Indicator Monitoring

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