ANNEX 8

Prudential Code for Capital Guidelines

Introduction

1. A major change in the system of capital financing in local government was introduced from 1 April 2004. Previously the government controlled how much new borrowing each local authority could take out each year. Now local authorities are able to determine their own programmes for capital investments and funding of the spending. The CIPFA[1] Prudential Code for Capital Finance in Local Authorities establishes the framework for local authority capital spending and funding to ensure that plans are affordable, prudent and sustainable. The purpose of this annex is to give a brief overview of the Code and its requirements and to advise members of the process that we will need to follow during the 2012/13 budget planning process.

An Overview of the Prudential Code

2. The Prudential Code sets out indicators that authorities must approve each year. The indicators must be approved by Council before 1 April each year, but can be revised during the year if required. For practical reasons, the indicators are considered and set each year at the same time as the Council sets the budget and council tax including those indicators that refer to Treasury Management which will be dealt with through the annual Treasury Management Strategy Report (Annex 6 of this report). A full set of all indicators required to be approved is set out at the end of this annex.

3. In setting or revising the prudential indicators, the Code requires local authorities to have regard to the following:

   - Affordability e.g. implications for council tax
   - Prudence and sustainability e.g. implications for external borrowing
   - Value for money e.g. option appraisal
   - Stewardship of assets e.g. asset management planning
   - Service objectives e.g. strategic planning for the authority
   - Practicality e.g. achievability of the forward plan.

4. It should be noted that the code does not include indicative limits or ratios for the indicators, rather it is for each authority to decide whether, taking all things into account, plans for capital investment are affordable, prudent and sustainable. Also, the prudential indicators are not designed to provide comparisons between authorities. Indicators reflect local circumstances and decisions and therefore comparisons could be misleading and counterproductive.

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[1] The Chartered Institute of Public Finance and Accountancy, the leading accountancy body for public services

5. Some of the indicators relating to external debt and treasury management replace existing limits the Council already approves annually. The Prudential Code is designed to sit alongside the authority's Treasury Management Strategy. The delegated responsibility for day-to-day management and decision making on treasury issues remains with the Chief Finance Officer, operating within the framework approved in the prudential indicators and the Treasury Management Strategy.

Monitoring of the Prudential Indicators

6. The Code requires the Chief Finance Officer to establish procedures to monitor performance against all forward looking indictors, in particular capital spending forecasts and to ensure that the net external borrowing does not exceed the total capital financing requirement (i.e. to ensure that borrowing is being used to finance capital expenditure and not revenue). Any significant deviations from the forward forecasts will need to be reported and acted upon.

Prudential Indicators

The prudential indicators below are those identified in the Prudential Guidelines relevant to Oxfordshire County Council:

Prudential Indicators for Affordability

1. Estimates of ratio of financing costs to net revenue stream

This compares the total principal and interest payments on external debt to the net revenue spending of the authority (i.e. that to be met from government grants and local taxpayers. This indicator needs to be calculated for the next three years.

2. Actual ratio of financing costs to net revenue stream

Similar to the first indicator but calculated directly from the consolidated revenue account.

3. Estimates of the incremental impact of capital investment decision on the council tax

The local authority will

(i) forecast the total budgetary requirements for the authority based on no changes to the existing capital programme

(ii) forecast the total budgetary requirements for the authority with the changes proposed to the capital programme included in the calculation

(iii) take the difference between (i) and (ii) and calculate the addition or reduction to council tax that would result.

This calculation shall 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.

Prudential Indicators for Prudence

4. Net Borrowing and the Capital Financing Requirement
This indicator should show that the net external borrowing does not exceed except in the short term, the capital financing requirement for the last year plus the estimates of any additions to the capital financing requirement for the current and two following years. Net external borrowing is the total of all borrowing, whether long or short term.

Capital Expenditure

5. Estimates of Capital Expenditure
The local authority 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.

6. Actual Capital Expenditure
After the year-end, the actual capital expenditure incurred during the financial year will be recorded.

7. Estimates of the Capital Financing Requirement
The local authority will make reasonable estimates of the total capital financing requirement at the end of the forthcoming financial year and the two following years. The capital finance requirement is designed to measure the council's underlying need to borrow, or finance by other long-term liabilities, for capital expenditure.

8. Actual capital financing requirement
After the year-end the actual capital financing requirement will be calculated directly from the local authority's balance sheet.

Treasury Management

The following indicators will be set as part of the annual Treasury Management Strategy Report that has to be approved by Council before the start of the financial year.

9. Code of Practice
The Local Authority is required to adopt the CIPFA Code of Practice for Treasury Management in the Public Services.

10. Interest Rate Exposure
This sets the authority's upper limits on the amount of net borrowing and relates to both fixed and variable interest rates. The indicator needs to be calculated for the following and next two financial years. The calculations are as follows:

Upper limit on fixed interest rates

Estimated interest payable on borrowing at fixed rates less investment interest receivable at fixed rates (as £ or %)

OR

Principal sums outstanding borrowed at fixed interest rates less principal sums invested at fixed interest rates (as £ or %)

Upper limit on variable interest rates

Estimated interest payable on borrowing at variable rates less investment interest receivable at variable rates (as £ or %)

OR

Principal sums outstanding borrowed at variable interest rates less principal sums invested at variable interest rates (as £ or %)

11. Maturity Structure of Borrowing

This sets upper and lower limits on the amount of fixed rate borrowing due to be repaid during the following periods:

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

This indicator is designed to be a control over an authority having large concentrations of fixed rate debt needing to be replaced at times of uncertainty over interest rates.

12. Total Principal Sums Invested for more than 364 days

This sets a maximum limit on the amount of money that can be invested for more than one year and needs to be calculated for each forward financial year period for the maturing of such investments.

External Debt

These indicators effectively replace the existing borrowing limits the council has to approve each year.

13. Authorised Limit

This is the maximum amount that the authority allows itself to borrow in each year and needs to be calculated for the forthcoming financial year and following two financial years. It needs to separately identify the limit for borrowing and any other long-term liabilities and covers both temporary and long-term borrowing. Any breach in the authorised limit needs to be reported to Council.

14. Operational Boundary

The local authority must set an operational boundary for its total external debt, gross of investments separately identifying borrowing from other long-term liabilities. This is also an external debt limit, but is set to reflect the most likely, prudent but not worst case scenario of the authority’s debt position, without the additional headroom included within the authorised limit to allow for unusual cash movements. It needs to be calculated for the next and following two financial years. Both the operational boundary and the authorised limit should link directly to the capital spending plans, capital financing requirement and cash flows of the authority. Any breaches in the operational boundary do not necessarily need to be reported, unless they are frequent or part of a trend.

15. Actual External Debt

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.

16. Gross and Net Debt

The local authority must set upper limits on its proportion of net debt compared to gross debt.