Appendix 7

PRUDENTIAL INDICATORS

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

The Authority's capital expenditure plans are the key driver of treasury management activity. The output of the capital expenditure plans is reflected in prudential indicators, which are designed to assist members' overview and confirm capital expenditure plans.

A Capital Expenditure

The Authority has to make a reasonable estimate of the capital expenditure that it plans to incur in the following three years and after the year-end must record the actual capital expenditure incurred in that year.

The Authority's capital programme informs the requirements of these indicators. The actual capital expenditure that was incurred by the Authority in 2014-15, the revised estimate for the current year and estimates for the future years are as follows:

2014-15 Actual £m	2015-16 Estimate £m	Capital Expenditure	2016-17 Estimate £m	2017-18 Estimate £m	2018-19 Estimate £m
2,264	5,592		14,999	2,256	2,056

The table below summarises the above capital expenditure plans and how these plans are being financed by capital or revenue resources. Any shortfall of resources results in a funding borrowing need:

2014-15 Actual £m	2015-16 Estimate £m	Capital Financing	2016-17 Estimate £m	2017-18 Estimate £m	2018-19 Estimate £m
2,139	2,750	Capital Grants and Reserves	2,745	0	0
95	43	Capital Receipts	110	110	55
30	2,799	Revenue Funding	12,144	2,146	2,001
2,264	**5,592**	**Total Capital Financing**	**14,999**	**2,256**	**2,056**

B Capital financing cost indicators

One of the indicators of affordability is the estimated ratio of the Authority's general fund capital financing costs to its net revenue stream in percentage terms. This indicator shows the proportion of the revenue budget spent on capital financing costs; if the ratio is increasing rapidly over time then a larger proportion of revenue resources is being taken up by capital financing costs, which could be used for other elements of the Authority's budget.

2014-15 **Actual** %	**2015-16** **Estimate** %	**Ratio of financing costs to net revenue stream**	**2016-17** **Estimate** %	**2017-18** **Estimate** %	**2018-19** **Estimate** %
1.28	1.22		1.33	1.27	1.19

C Capital Financing Requirement

The Capital Financing Requirement (CFR) indicator is a notional figure which shows the Authority's theoretical need to borrow to fund capital expenditure. Any capital expenditure above, which has not immediately been paid for, will increase the CFR.

The CFR does not increase indefinitely, as the Minimum Revenue Provision (MRP) is a statutory annual revenue charge which broadly reduces the borrowing need.

The CFR includes any other long term liabilities (e.g. PFI schemes, finance leases). Whilst these increase the CFR, and therefore the Authority's borrowing requirement, these types of scheme include a borrowing facility and so the Authority is not required to separately borrow for these schemes.

2014-15 **Actual** **£m**	**2015-16** **Estimate** **£m**	**Capital Financing Requirement (CFR)**	**2016-17** **Estimate** **£m**	**2017-18** **Estimate** **£m**	**2018-19** **Estimate** **£m**
9,414	**8,783**	**CFR** brought forward	**8,195**	**7,646**	**7,134**
		Movement in CFR represented by			
0	0	Net financing need for the year	0	0	0
(631)	(588)	Less MRP, other financing movements	(549)	(512)	(478)
8,783	**8,195**	**CFR** carried forward	**7,646**	**7,134**	**6,656**

D Gross Borrowing Requirement

There is a clear linkage between the Authority's Capital Financing Requirement indicators and its gross external borrowing. Within the code there is a key indicator of prudence that ensures that, over the medium term, gross borrowing is only for a capital purpose. This can be demonstrated by comparing gross external borrowing shown in the table below to the total CFR in the preceding year plus the estimates of any additional CFR for the current and next two financial years. Gross external borrowing should not exceed this limit except in the short term.

The Authority's treasury portfolio position at 31st March 2015, with forward projections is summarised below. The table shows the actual external debt (the treasury management operation), against the underlying capital borrowing need (the Capital Financing Requirement (CFR)), highlighting any over or under borrowing:

2014-15 Actual £m	2015-16 Estimate £m	Current Portfolio Position	2016-17 Estimate £m	2017-18 Estimate £m	2018-19 Estimate £m
		External Debt			
2,214	2,258	Debt at 1 April	2,247	1,914	1,903
44	(11)	Expected change in Debt	(333)	(11)	(11)
2,258	2,247	External Debt at 31 March	1,914	1,903	1,892
69	59	Other LT Liabilities (OLTL)	49	39	29
(10)	(10)	Expected change in OLTL	(10)	(10)	(10)
2,317	2,296	Actual Gross Debt at 31 March	1,953	1,932	1,911
8,783	8,195	Capital Financing Requirement	7,646	7,133	6,656
6,466	**5,899**	**Under / (over) borrowing**	**5,693**	**5,201**	**4,745**

The Head of Finance reports that he does not envisage the position indicated above leading to future difficulties for the Authority. This view takes into account current commitments, existing plans, and the proposals in this budget report.

E Impact of Capital Investment Decisions on Authority Tax

The other indicator of affordability is the estimate of the incremental impact on Authority Tax, over and above capital investment decisions that have previously been taken by the Authority. This indicator identifies the revenue costs associated with proposed changes to the three year capital programme recommended in this budget report compared to the Authority's existing approved commitments and current plans. The assumptions are based on the budget, but will invariably include some estimates, such as the level of Government support, which are not published over a three year period. The indicator is intended to show the effect on Authority Tax of approving new capital expenditure in the capital programme.

The Authority has a strategy of funding capital from grant, revenue or reserves and the impact of this is included in the MTFP and the reserves strategy. The capital programme currently estimated does not therefore add any additional revenue cost to the budget.

F Authorised Limit for external debt

A further key prudential indicator represents a control on the maximum level of borrowing. This represents a limit beyond which external debt is prohibited, and this limit needs to be set or revised by the full Authority. It reflects the level of external debt which, while not desired, could be afforded in the short term, but is not sustainable in the longer term.

The Authority has to set an Authorised Limit, which is the statutory maximum borrowing permitted, and an operational boundary, which is the normal level of borrowing expected, for external debt.

The Authorised Limits set out below are consistent with the Authority's current commitments, existing plans and the proposals set out in this report for the capital expenditure and financing, and with its approved treasury policy statement and practices. They are based on the most likely, prudent, but not worse case scenario, with sufficient headroom over and above this to allow for operational management recognising that during the year it may be necessary to exceed the operational boundary in order to take advantage of interest rate movements or to accommodate unusual cash flow movements.

2014-15 Actual £m	2015-16 Estimate £m	Authorised Limit for External Debt	2016-17 Estimate £m	2017-18 Estimate £m	2018-19 Estimate £m
		Borrowing			
4,317	4,296	Other Long Term Liabilities	3,953	3,932	3,911
4,317	**4,296**	**Total Authorised Limit**	**3,953**	**3,932**	**3,911**

In agreeing these limits, it should be noted that the Authorised Limit for 2016-17 will be the statutory limit determined under Section 3 (1) of the Local Government Act 2003. The Government retains an option to control either the total of all authorities' plans, or those of a specific authority, although this power has not yet been exercised. This indicator is the maximum limit the Authority may borrow at any point in time in the year. If borrowing above this level were needed a report would go to Authority for authorisation to increase the limit.

G Operational Boundary for external debt

The operational boundary is a key management tool for in-year monitoring. Temporary breach of the operational boundary will not in itself be a cause for concern, although a sustained breach might indicate an underlying issue that would need investigation and action.

The operational boundaries below are based on the Authorised Limit, estimating the Authority's most likely level of borrowing and leasing each year. It includes long term borrowing to fund capital and short term borrowing to meet day to day variations in cash flow but without the additional headroom.

This is the limit which external debt is not normally expected to exceed. In most cases, this would be a similar figure to the CFR, but may be lower or higher depending on the levels of actual debt.

2014-15 Actual £m	2015-16 Estimate £m	Operational Boundary	2016-17 Estimate £m	2017-18 Estimate £m	2018-19 Estimate £m
2,214	2,214	Debt	1,892	1,892	1,892
103	100	Other long term liabilities	100	100	100
2,317	**2,314**	**Total**	**1,992**	**1,992**	**1,992**

Treasury management limits on activity

There are three debt related treasury activity limits. The purpose of these is to restrain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of any adverse movement in interest rates. However, if these are set to be too restrictive they will impair the opportunities to reduce costs / improve performance. The indicators are:

H Maturity structure of debt

It is recommended that the Authority sets upper and lower limits for the maturity structure of its debt for the forthcoming year as follows:

Maturity Structure of Authority Borrowing	Lower Limit %	Upper Limit %
Under 12 months	0%	25%
12 months to 2 years	0%	25%
2 years to 5 years	0%	40%
5 years to 10 years	0%	60%
10 years and above	5%	100%

The above percentages are the ranges for the projected borrowing maturing in each year out of the total projected borrowing. The indicator is designed to be a control over the Authority having large concentrations of fixed interest rate debt needing to be replaced at any one time and thus being at risk of having to borrow large amounts when interest rates may be unfavourable.

I Fixed interest rate exposure

The table below shows the Authority's upper limit for fixed interest rate exposure for the next three years. This indicator shows the percentage of borrowing that can be undertaken at fixed interest rates. Up to 100% of borrowing can be at fixed interest rates. Again, this indicator is set at levels to reduce the risk from interest rate movements.

Upper Limit – Fixed Interest Rate Exposure	**2016-17 %**	**2017-18 %**	**2018-19 %**
Fixed Interest Rates	100	100	100

J Variable interest rate exposure

The following indicator shows the percentage of borrowing that can be undertaken at variable interest rates. The purpose of the indicator is to restrict variable rate borrowing in order to reduce the risk from sudden movements in interest rates. The Authority sets its upper limit for borrowing, reflecting variable interest rates less investments that are variable rate investments at 40%.

Upper Limit – Variable Interest Rate Exposure	**2016-17 %**	**2017-18 %**	**2018-19 %**
Variable Interest Rates	40	40	40

Currently 100% of the borrowing is fixed rate, which is within these limits.

K Investment periods

It is recommended that the Authority sets a limit on the amount invested for periods longer than one year of £5m in total for 2016-17, with the maximum period for any one loan being three years. These limits are set with regard to the Authority's liquidity requirements and to reduce the need for early sale of an investment and are based on the availability of funds after each year-end.

Upper Limit for Total Principal Sums Invested for over 364 days	**2016-17 Estimate £m**	**2017-18 Estimate £m**	**2018-19 Estimate £m**
External Debt	5	5	5