

Report to:	Cabinet Council	Date of Meeting:	13 February 2020 27 February 2020
Subject:	The Prudential Code for Capital Finance in Local Authorities - Prudential Indicators 2020/21		
Report of:	Head of Corporate Resources	Wards Affected:	All Wards
Portfolio:	Cabinet Member - Regulatory, Compliance and Corporate Services		
Is this a Key Decision:	Yes	Included in Forward Plan:	Yes
Exempt / Confidential Report:	No		

Summary:

The CIPFA Prudential Code for Capital Finance in Local Authorities was introduced following the Local Government Act 2003. It details a number of measures / limits / parameters (Prudential Indicators) that are required to be set each financial year. The approval of these limits will provide a benchmark to measure actual performance against, to help ensure that the Council complies with relevant legislation, is acting prudently and that its capital expenditure proposals are affordable.

Recommendation(s):

Cabinet is recommended to:

- 1) Recommend to Council that the Prudential Indicators (as detailed in the report) are set as the basis for compliance with The Prudential Code for Capital Finance in Local Authorities;
- 2) Note that the relevant Prudential Indicators will be revised as required and that any changes will be brought to Cabinet and then to Council for approval;
- 3) Note that the estimates of capital expenditure may change as grant allocations are received; and
- 4) Recommend to Council that authority is delegated to the Head of Corporate Resources in conjunction with the Cabinet Member – Regulatory, Compliance and Corporate Services to manage the Authorised Limit and Operational Boundary for external debt as detailed in Section 5 of the report.

Council is recommended to:

- 1) Approve the Prudential Indicators (as detailed in the report) as the basis for compliance with The Prudential Code for Capital Finance in Local Authorities;
- 2) Note that relevant Prudential Indicators will be revised as required and that any changes will be brought to Cabinet and then to Council for approval;
- 3) Note that the estimates of capital expenditure may change as grant allocations are received; and
- 4) Delegate authority to the Head of Corporate Resources in conjunction with the Cabinet Member – Regulatory, Compliance and Corporate Services to manage the Authorised Limit and Operational Boundary for external debt as detailed in Section 5 of the report.

Reasons for the Recommendation(s):

To enable the Council to effectively manage its Capital Financing activities and comply with the CIPFA Prudential Code for Capital Finance in Local Authorities. The prudential indicators for the forthcoming and following years must be set before the beginning of the forthcoming year.

Alternative Options Considered and Rejected:

None

What will it cost and how will it be financed?

(A) Revenue Costs

n/a

(B) Capital Costs

n/a

Implications of the Proposals:

Resource Implications (Financial, IT, Staffing and Assets): The prudential indicators will allow for capital spending obligations to be managed within the budget for 2020/21.
Legal Implications: None.
Equality Implications: None.

Contribution to the Council's Core Purpose:

Protect the most vulnerable: n/a
Facilitate confident and resilient communities: n/a
Commission, broker and provide core services: n/a
Place – leadership and influencer: Support strategic planning and promote innovative, affordable and sustainable capital investment projects through application of the CIPFA Prudential Code.
Drivers of change and reform: n/a
Facilitate sustainable economic prosperity: Support Capital Investment by measuring the impact and affordability of decisions over the medium-term financial planning horizon.
Greater income for social investment: n/a
Cleaner Greener: n/a

What consultations have taken place on the proposals and when?

(A) Internal Consultations

The Head of Corporate Resources (FD5943/20) and the Chief Legal and Democratic Officer (LD4126/20) have been consulted and any comments have been incorporated into the report.

(B) External Consultations

None.

Implementation Date for the Decision

With immediate effect.

Contact Officer:	Graham Hussey
Telephone Number:	0151 934 4100
Email Address:	Graham.Hussey@sefton.gov.uk

Appendices:

There are no appendices to this report

Background Papers:

There are no background papers available for inspection.

1. Introduction

- 1.1. The CIPFA Prudential Code for Capital Finance in Local Authorities (The Prudential Code) was introduced following the Local Government Act 2003. It details a number of measures/limits/parameters (Prudential Indicators) that are required to be set each financial year. The approval of these limits will ensure that the Council complies with the relevant legislation, is acting prudently and that its capital expenditure proposals are affordable.
- 1.2. CIPFA introduced a revised version of the code in December 2017 and this has been adopted in setting the estimated Prudential Indicators for financial years 2019/20 to 2022/23.
- 1.3. The Council is required to approve Prudential Indicators for the following items:
 - (i) Capital Expenditure (Section 2);
 - (ii) Financing Costs/Net Revenue Stream (Section 3);
 - (iii) Capital Financing Requirement (Section 4);
 - (iv) External Debt (Section 5-7);
 - (v) Treasury Management Indicators (Section 8).

These indicators are presented in the following paragraphs and summarised at Annex A.

2. Prudential Indicator – Capital Expenditure

- 2.1. This indicator details the overall total planned capital expenditure of the Council and therefore reflects the Council's Capital Programme.
- 2.2. The actual capital expenditure that was incurred in 2018/19 and the estimated current and future years capital programme are recommended for approval:

Capital Expenditure - 2018/19 to 2022/23					
	2018/19 £m Actual	2019/20 £m Estimate	2020/21 £m Estimate	2021/22 £m Estimate	2022/23 £m Estimate
TOTAL	23.019	27.579	56.817	9.068	1.911

- 2.3. The estimated levels of expenditure above represent those elements approved by Council and which have been included within the Capital Programme, as well as projected expenditure such as Highways Capitalisation.
- 2.4. The increase in capital expenditure during 2020/21 represents additional allocations added as part of the traditional capital programme and new schemes included in the Council's Strategic Investment Programme. The majority of the additional expenditure will be funded from external grants, contributions and capital receipts. This may change as grant allocations and additional capital schemes are made known to the Council and are approved for inclusion within the Capital Programme.

3. Prudential Indicator – Financing Costs/Net Revenue Stream

- 3.1. This indicator measures the total capital financing costs of capital expenditure as a proportion of the total level of income from Government Grants, local Council Tax and Business Rates payers. This measure demonstrates the affordability of capital plans by comparing the cost of borrowing undertaken to fund the capital programme (in previous years and for planned expenditure in future years) to the net revenue available to the Council in each of those years.
- 3.2. Actual figures for 2018/19 and estimates of the ratio for 2019/20 and future years are:

Financing Costs / Net Revenue Stream					
	2018/19 £m Actual	2019/20 £m Estimate	2020/21 £m Estimate	2021/22 £m Estimate	2022/23 £m Estimate
Ratio	3.5%	3.7%	4.1%	4.0%	3.8%

- 3.3. The estimates of financing costs include current commitments and proposals contained in the capital programme and new borrowing requirements in the Capital Programme. These borrowing requirements include projects and schemes that generate savings and income streams to the council that support repayment schedules.
- 3.4. The increase in financing costs forecast during 2020/21 is the result of an upfront payment to Merseyside Pension Fund (currently estimated to be £43.623m) which will be funded by borrowing.
- 3.5. The Merseyside Pension Fund has offered the Council the opportunity to prepay (in April 2020) a proportion of the total expected contributions for the three-year valuation period at a discount. The Council has previously taken a similar opportunity at the start of the last two valuation periods. Officers have discussed the proposal with both the Merseyside Pension Fund and the Council's external auditors.
- 3.6. The borrowing will be repaid across the three years of the valuation period, funded by the Council making significantly reduced payments the Merseyside Pension Fund each month during the period. After allowing for these borrowing costs, as stated this will generate a significant net saving to the Council.

4. Prudential Indicator – Capital Finance Requirement

- 4.3. The Capital Financing Requirement (CFR) indicator reflects the Authority's underlying need to borrow for a capital purpose. This is based on historic capital financing decisions and a calculation of future years planned capital expenditure requirements.

- 4.4. Actual 2018/19 and estimated year-end Capital Financing Requirements for current and future years are set out in the table below:

Capital Financing Requirement					
	31/03/19 £m Actual	31/03/20 £m Estimate	31/03/21 £m Estimate	31/03/22 £m Estimate	31/03/23 £m Estimate
CFR	231.762	230.572	239.544	233.858	227.844

5. Prudential Indicator – Borrowing Limits

- 5.1. External borrowing undertaken by the Council arises as a consequence of all the financial transactions of the Authority, both capital and revenue, and not simply those arising from capital spending. The Council manages its Treasury Management position in terms of its external borrowings and investments in accordance with its approved Treasury Management Strategy and Policy Statements. These documents are presented for approval elsewhere on this agenda.

5.2. The Operational Boundary

- 5.2.1. The Operational Boundary sets a limit on the total amount of long-term borrowing that the Council can undertake. It reflects the Authority's current commitments, existing capital expenditure plans, and is consistent with approved Treasury Management Policy Statement and practices. The figures are based on prudent estimates.

- 5.2.2. In respect of the Operational Boundary, it is recommended that the Council approves the following limits for the next three financial years. These limits separately identify borrowing from other long-term liabilities arising from finance leases, PFIs and the transferred debt from the now defunct Merseyside Residuary Body.

Operational Boundary				
	2019/20 £m	2020/21 £m	2021/22 £m	2022/23 £m
Borrowing	178.000	229.000	213.000	210.000
Other Long-Term Liabilities	11.000	10.000	9.000	8.000
TOTAL	189.000	239.000	222.000	218.000

- 5.2.3. The Council is asked to approve these limits and to delegate authority to the Head of Corporate Resources in conjunction with the Cabinet Member – Regulatory, Compliance and Corporate Services to manage the movement between the

separately agreed limits for borrowing and other long-term liabilities within the total limit for any individual year.

5.3. The Authorised Limit

5.3.1. The Authorised Limit sets a boundary on the amount of borrowing (both short and long-term) that the Council undertakes. It uses the Operational Boundary as its base but also includes additional headroom to allow, for example, for exceptional cash movements. Under the terms of section 3 (1) of the Local Government Act 2003, the Council is legally obliged to determine and review how much it can afford to borrow i.e. the Authorised Limit. The Authorised Limit determined for 2020/21 will be the statutory limit determined under section 3 (1).

5.3.2. The Council is asked to delegate authority to the Head of Corporate Resources in conjunction with the Cabinet Member – Regulatory, Compliance and Corporate Services to manage the movement between the separately agreed limits for borrowing and other long-term liabilities within the total limit for any individual year. Any such changes will be reported to Members at the next available meeting. The Authorised Limit for external debt is as follows:

Authorised Limit				
	2019/20 £m	2020/21 £m	2021/22 £m	2022/23 £m
Borrowing	188.000	239.000	223.000	220.000
Other Long Term Liabilities	11.000	10.000	9.000	8.000
TOTAL	199.000	249.000	232.000	228.000

6. Prudential Indicator – Actual External Debt

6.1. The Prudential Code requires that in setting indicators for 2020/21, the Council reports its actual levels of external debt as at 31st March 2019. The Council's actual external debt at 31st March 2019 was:

	31/03/2019 £m
Borrowing	148.692
Other Long Term Liabilities	10.158
TOTAL	158.850

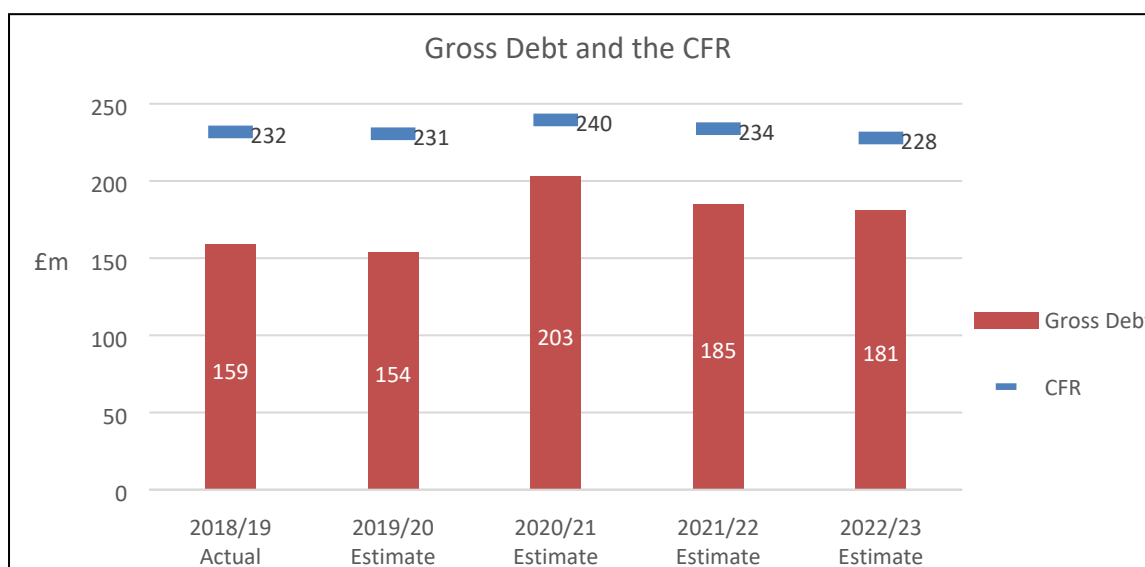
7. Gross Debt and the Capital Financing Requirement

7.1. This prudential indicator is used to ensure that the authority does not borrow in advance of need. If the authority borrowed in advance of need then the net position would be negative – i.e. borrowing greater than the CFR.

7.2. CIPFA's Prudential Code for Capital Finance in Local Authorities includes the following statement as a key indicator of prudence:

“In order to ensure that the medium-term net borrowing will only be for a capital purpose, the local authority should ensure that net external borrowing does not, except in the short-term, exceed the total of capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years”.

7.3. The chart below illustrates that the Council is not intending to borrow in advance of need, and that there is a significant level of “under borrowing”.



7.4. The increase in gross debt forecast during 2020/21 represents an upfront payment to Merseyside Pension Fund funded by borrowing. As mentioned in paragraph 3.5 (above) this will generate a significant saving to the Council whilst still maintaining the under borrowing position.

8. Prudential Indicators – Treasury Management

8.1. The Council has adopted the CIPFA Code of Practice for Treasury Management in Public Services. The annual Policy and Strategy Documents establish the following debt maturity profiles and an upper limit for investments made by the Council for more than 365 days:

8.2. Debt Maturity Profile

8.2.1. A debt maturity profile is detailed in the following tables i.e. the amount of borrowing that is maturing in each period as a percentage of total projected borrowing for fixed rate and variable rate debt.

Debt Maturity – Fixed Rate Borrowing

	<u>Upper</u> <u>Limit</u>	<u>Lower</u> <u>Limit</u>
Under 12 months	35%	0%
12 months and within 24 months	40%	0%
24 months and within 5 years	40%	0%
5 years and within 10 years	40%	0%
10 years and within 15 years	40%	0%
15 years and above	90%	30%

Debt Maturity – Variable Rate Borrowing

	<u>Upper</u> <u>Limit</u>	<u>Lower</u> <u>Limit</u>
Under 12 months	100%	0%
12 months and within 24 months	100%	0%
24 months and within 5 years	100%	0%
5 years and within 10 years	0%	0%
10 years and above	0%	0%

8.3. Principal Sums Invested for Periods Longer Than 365 Days

8.3.1. An upper limit on the value of principal sums invested for periods over 365 days (as approved in the annual Treasury Management Policy and Strategy Documents) is set at 40% of total investments. This limit is set to contain the authority's exposure to the possibility of loss that might arise as a result of having to seek early repayment of principal sums invested.

8.3.2. This limit will be kept under review to take advantage of any opportunities in the current money market.

9. Monitoring Prudential Indicators

9.1. Having established the Prudential Indicators, the Head of Corporate Resources will monitor them during the year and report on actual performance to the Audit & Governance Committee on a quarterly basis. An outturn report of performance against the Prudential Indicators will be presented to both Cabinet and Council following the financial year end.

10. Impact of IFRS 16 on Prudential Indicators

10.1. It is anticipated that the Code of Practice on Local Authority Accounting in the United Kingdom for 2020/21 will include the implementation of International Financial Reporting Standard (IFRS) 16 relating to leases. This will materially alter

the way in which Local Authorities must identify and recognise leased assets and any associated liabilities within their financial statements.

- 10.2. The changes to the accounting code will mean that Local Authorities may need to recognise some assets previously classified under operating leases as capital expenditure. This recognition of additional leased assets could therefore, increase the estimates of Capital Expenditure and the Capital Financing Requirement reported for 2020/21 and future years. Borrowing limits may also need to be updated to reflect the liability component of the leasing agreement.
- 10.3. It should be noted however, that leases of a short-term nature (less than 12 months) and those where the underlying asset is of low value will be exempted from the changes under IFRS 16.
- 10.4. Officers will be undertaking work during 2020/21 financial year to identify any leasing arrangement that require reclassification in time for the preparation of the financial statements in early 2021/22. A further report will be brought to Cabinet and Council should any update to the prudential indicators be required as a result of the implementation of IFRS 16.

Summary of Prudential Indicators.

ANNEX A

Capital Expenditure - 2018/19 to 2022/23					
	2018/19 £m Actual	2019/20 £m Estimate	2020/21 £m Estimate	2021/22 £m Estimate	2022/23 £m Estimate
TOTAL	23.019	27.579	56.817	9.068	1.911

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Operational Boundary					
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Authorised Limit					
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External Debt	31/03/2019 £m
Borrowing	148.692
Other Long-Term Liabilities	10.158
TOTAL	158.850

Gross Debt and the CFR	2018/19 £m Actual	2019/20 £m Estimate	2020/21 £m Estimate	2021/22 £m Estimate	2022/23 £m Estimate
CFR	231.762	230.572	239.544	233.858	227.844
Gross Borrowing	158.850	154.078	202.902	185.246	180.967
Under / (Over) Borrowing	72.912	76.494	36.642	48.612	46.877

Debt Maturity – Fixed Rate Borrowing	<u>Upper Limit</u>	<u>Lower Limit</u>
Under 12 months	35%	0%
12 months and within 24 months	40%	0%
24 months and within 5 years	40%	0%
5 years and within 10 years	40%	0%
10 years and within 15 years	40%	0%
15 years and above	90%	30%

Debt Maturity – Variable Rate Borrowing	<u>Upper Limit</u>	<u>Lower Limit</u>
Under 12 months	100%	0%
12 months and within 24 months	100%	0%
24 months and within 5 years	100%	0%
5 years and within 10 years	0%	0%
10 years and above	0%	0%

Principal Sums Invested for Longer than 365 Days	<u>Lower Limit</u>	<u>Upper Limit</u>
	0%	40%