Appendix B (iii)

2021-2025 Prudential Indicators

Introduction

1.0 The Local Government Act 2003 requires the Authority to adopt the CIPFA Prudential Code and produce prudential indicators. The framework established by the Prudential Code is designed to support local strategic planning, local asset management planning and proper option appraisal. The objectives of the Prudential Code are to ensure, within a clear framework, that the capital expenditure plans of local authorities are affordable, prudent and sustainable, and that treasury management decisions are taken in accordance with good professional practice and in full understanding of the risks involved and how these risks will be managed to levels that are acceptable to the organisation. In exceptional cases the Prudential Code should provide a framework which will demonstrate that there is a danger of not ensuring this, so that the local authority concerned can take timely remedial action.

1.1 The Prudential Code requires authorities to look at capital expenditure and investment plans in the light of overall organisational strategy and resources and ensure that decisions are being made with sufficient regard to the long run financing implications and potential risks to the authority. Effective financial planning, option appraisal, risk management and governance processes are essential in achieving a prudential approach to capital expenditure, investment and debt. The Capital Investment Strategy Is included as Appendix B (iii) to this report.

1.2 To demonstrate that local authorities have fulfilled these objectives, the Prudential Code sets out the indicators that must be used, and the factors that must be taken into account. The Prudential Code does not include suggested indicative limits or ratios. These will be for the local authority to set itself. Each indicator either summarises the expected capital activity or introduces limits upon that activity, and reflects the outcome of the Authority's underlying investment appraisal systems.

1.3 Within this overall prudential framework there is an impact on the Authority's treasury management activity as it will directly impact on borrowing and investment activity. The draft Treasury Management Strategy for 2019/20 is included within the annex to this report.

1.4 The Prudential Code requires the following matters to be taken into account when setting or revising the prudential indicators:

a) Service Objectives – e.g. strategic planning for the Authority
b) Stewardship of assets – e.g. asset management strategy
c) Value for money – e.g. options appraisal
d) Prudence and sustainability – e.g. implications of external borrowing
e) Affordability – e.g. impact on Housing rents
f) Practicality – e.g. achievability of the forward plan

1.5 Matters of affordability and prudence are primary roles for the Prudential Code.

1.6 The revenue consequences of capital expenditure relating to the HRA must to be paid for from HRA resources.

1.7 Capital expenditure can be paid for through capital receipts, grants etc, but if these resources are insufficient then any residual capital expenditure will add to the HRA's borrowing need.

1.8 The key risks to the plans are that the level of funding, such as capital receipt levels or revenue contributions may change as capital receipts are reliant on an active property market.

1.9 The indicators cover:

- Affordability;
- Prudence;
- Capital expenditure;
- External debt; and
- Treasury management.

1.10 Prudential indicators are required to be set as part of the Financial Planning and Budget process. Any revisions must be reported through the financial management process.

1.11 The prudential indicators for the forthcoming and future years must be set before the beginning of the forthcoming year. They may be revised at any time, following due processes and must be reviewed, and revised if necessary, for the current year when the prudential indicators are set for the following year.

1.12 The following sets down the draft Prudential Indicators as calculated and proposed for North Tyneside Council for 2020–2024. The indicators include those for the Housing Revenue Account.

Prudential Indicators for Affordability

1.13 The fundamental objective in considering affordability of the Authority's Investment Plan is to ensure that the total capital investment of the Authority remains within sustainable limits, and in particular to consider the impact on the "bottom line" and hence Council Tax and Housing rents. Affordability is ultimately determined by a judgement on acceptable Council Tax or housing rent levels.

1.14 In considering the affordability of its Investment Plan, the Authority is required to consider all the resources that are currently available and estimated for the future, together with the totality of the Investment Plan, revenue income and revenue expenditure forecasts for the forthcoming year and following two years (as a minimum). The Authority is also required to consider known significant variations beyond this timeframe. This requires the development of rolling revenue forecasts as well as capital expenditure plans. In line with the Financial Plan and the Investment Plan, four-year forecasts have been provided for the prudential indicators.

1.15 When considering affordability, risk is an important factor to be considered. Risk analysis and management strategies should be taken into account.

1.16 Looking ahead for a four year period, the following is a key prudential indicator of affordability:

- the ratio of financing costs to net revenue stream for both the Housing Revenue Account (HRA) and non-HRA services.

<u>Ratio of financing costs to net revenue stream</u>

1.17 This indicator identifies the trend in the cost of capital (predominately external interest and MRP) as a proportion of the net revenue budget for the General Fund and housing income for the HRA and is shown in Table 1 below:

Table 1: Ratio of Financing Costs to Net Revenue Stream

	2020/21	**2021/22**	**2022/23**	**2023/24**	**2024/25**
	Est.	**Est.**	**Est.**	**Est.**	**Est.**
General Fund	17.09%	17.90%	16.42%	16.36%	16.32%
HRA	28.91%	27.90%	27.33%	26.49%	23.68%

1.18 The above indicator shows costs for all borrowing, both supported and unsupported. It also includes the financing costs of PFI schemes and leases. A new accounting standard for leasing (IFRS16) was due to come into force for Local Authorities from 1 April 2020 due to the Covid-19 pandemic this has been delayed until 1 April 2021. Under this new standard leases that have previously been treated as operating leases and expensed to the revenue account on an annual basis, will now be required to be added to the authority's balance sheet. An initial estimate of the impact of this change (£4m pa) to the cost of capital has been added to the above calculation. Work is ongoing to calculate the actual impact of this change on the cost of borrowing. This will be reported through the Financial Management reports to Cabinet. It should be noted that there is not expected to be a bottom line impact to the revenue budget.

To enhance the information available for decision-making we have also provided a local indicator to show the proportion of the budget that is spent on unsupported borrowing. This is shown in Table 2 below:

Table 2: Ratio of Financing Costs for prudential (unsupported) borrowing to Net Revenue Stream

	2020/21	**2021/22**	**2022/23**	**2023/24**	**2024/25**
	Est.	**Est.**	**Est.**	**Est.**	**Est.**
General Fund	11.60%	12.34%	11.38%	11.18%	11.08%
HRA	6.88%	5.85%	5.23%	4.85%	0.38%

1.19 The cost of capital related to past and current capital programmes has been estimated in accordance with proper practices. Actual costs will depend on the phasing of capital expenditure and prevailing interest rates, and will be closely managed and monitored on an ongoing basis. Any reprogramming in the Investment Plan, whether planned or unplanned, may delay the impacts of debt financing costs to future years.

<u>Prudential Indicators for Prudence</u>

1.20 A key indicator of prudence is that, over the medium term, gross debt will only be used for a capital purpose. Under the Code the underlying need to borrow for a capital purpose is measured by the Capital Financing Requirement (CFR). Gross debt includes external borrowing and also other liabilities including PFI schemes and Finance Leases.

<u>Gross debt and Capital Financing Requirement (CFR)</u>

1.21 This key indicator shows that gross debt is not expected to exceed the total CFR including additional capital requirements for 2017/18 to 2022/23.

Table 3: Gross external debt compared to CFR

	2020/21	2021/22	2022/23	2023/24	2024/25
	Est.	Est.	Est.	Est.	Est.
	£000s	£000s	£000s	£000s	£000s
External Borrowing	460,901	464,332	458,721	453,270	450,731
Other Liabilities (including PFI and Finance Leases)	113,527	185,175	181,711	180,738	176,957
Total Gross debt	574,428	649,507	640,432	634,008	627,688
Capital Financing requirement	**635,184**	**704,355**	**690,036**	**678,831**	**660,647**

<u>Prudential Indicators for Capital Expenditure</u>

<u>Estimate of capital expenditure</u>

1.22 This indicator requires reasonable estimates of the total capital expenditure to be incurred during the current financial year and at least the following three financial years.

1.23 The Investment Plan for 2020-2026 is included in the annex to the report and the figures below are based on that report. A full breakdown of individual projects is shown in Appendix B (i).

Table 4: Capital Expenditure

	2019/20 Est. £000s	2021/22 Est. £000s	2022/23 Est. £000s	2023/24 Est. £000s	2024/25 Est. £000s
General Fund	49,648	35,842	15,352	15,458	15,988
HRA	25,227	26,362	26,043	27,400	29,949
Total	**74,875**	**62,204**	**41,395**	**42,858**	**45,937**

1.24 There is a risk of cost variations to planned expenditure against the Investment Plan, arising for a variety of reasons, including tenders coming in over/under budget, changes to specifications, slowdown/acceleration of project phasing. There is also the possibility of needing to bring urgent and unplanned capital works into the Investment Plan. These risks are managed by project officers on an ongoing basis, by means of active financial and project monitoring, they will be overseen by the Investment Programme Board and any changes will be made in accordance with Financial Regulations.

1.25 The availability of financing from capital receipts, grants and external contributions also carry significant risks. These risks are particularly relevant to capital receipts, where market conditions are a key driver to the flow of funds, causing problems in depressed or fluctuating market conditions. There is a much reduced reliance on capital receipts in the proposed plan.

<u>Estimate of Capital Financing Requirement (CFR)</u>

1.26 The CFR can be understood as the Authority's underlying need to borrow money long term for a capital purpose. The CFR is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. The CFR will increase annually by the amount of capital expenditure which is not immediately paid for by grants, contributions, direct revenue funding or capital receipts. The General Fund CFR will also be reduced each year by the amount of Minimum Revenue Provision (MRP) that is set aside in the revenue budget. In addition, the CFR may be reduced by additional voluntary contributions in the form of capital receipts or revenue contributions. The HRA business plan includes provision to reduce the HRA CFR in this way.

1.27 The CFR also includes any other long term liabilities eg PFI schemes and finance leases. As outlined in paragraph 1.18 above the new accounting standard for leasing (IFRS16) now comes into force for Local Authorities from 1 April 2021. This means that leases that have previously been treated as operating leases and expensed to the revenue account on an annual basis, are now required to be added to the authority's balance sheet. An initial estimate of the impact of this change (£75m) has been added to the CFR. Work is ongoing to calculate the actual impact of this change on the CFR. This will be reported through the Financial Management reports to Cabinet.

1.28 In accordance with best professional practice the Authority does not associate borrowing with particular items or types of expenditure. The Authority has a number of daily cash flows, both positive and negative, and manages its treasury position in terms of its borrowing and investments in accordance with the approved Treasury Management Strategy. In day to day cash management no distinction can be made between revenue cash and capital cash. Over the long term external borrowing may only be incurred for capital purposes.

Table 5: Capital Financing Requirement

	2020/21 Est. £000s	2021/22 Est. £000s	2022/23 Est. £000s	2023/24 Est. £000s	2024/25 Est. £000s
General Fund	319,454	394,011	384,862	378,844	364,477
HRA	315,730	310,343	305,174	299,987	296,170
Total	**635,184**	**704,355**	**690,036**	**678,831**	**660,647**

1.29 The above indicator shows the total borrowing requirement, both supported and unsupported. To enhance the information available for decision-making we have provided a local indicator to show the Capital Financing Requirement for unsupported borrowing. This is shown in Table 6 below:

Table 6: Capital Financing Requirement for Unsupported Borrowing

	2020/21 Est. £000s	2021/22 Est. £000s	2022/23 Est. £000s	2023/24 Est. £000s	2024/25 Est. £000s
General Fund	184,285	188,805	184,048	179,814	176,545
HRA	11,002	7,171	3,671	274	0
Total	207,261	195,976	187,719	180,088	176,545

Prudential Indicators for External Debt

Authorised limit for total external debt

1.30 For the purposes of this indicator the authorised limit for external debt is defined as the authorised limit for borrowing plus the authorised limit for other long term liabilities.

1.31 This indicator requires the Authority to set, for the forthcoming financial year and following years, an authorised limit for total external debt, separately identifying borrowing from other long term liabilities such as PFI and Finance Leases.

1.32 The authorised limit represents the maximum amount the Authority may borrow at any point in time in the year. It has to be set at a level the Authority considers is “prudent” and has to be consistent with the plans for capital expenditure and financing.

1.33 This limit is based on the estimate of the most likely, but not worse case, scenario with additional headroom to allow for operational management, for example unusual cash movements.

1.34 As outlined in paragraphs 1.18 and 1.27 above the new accounting standard for leasing (IFRS16) comes into force for Local Authorities from 1 April 2020. An uplift has been applied to the external and operational boundaries to allow for this change. Work is ongoing to calculate the actual impact of the change. This will be reported through the Financial Management reports to Cabinet.

1.35 Full Council will be requested to approve these limits and to delegate authority to the Chief Finance Officer, within the total limit for any individual year, to effect movement between the separately agreed limits for borrowing and other long-term liabilities, in accordance with option appraisal and best value for money for the Authority.

1.36 Any such changes made will be reported to the Cabinet at its next meeting following the change.

Table 7: Authorised Limit for External Debt

	2019/20 Est. £000s	**2020/21 Est. £000s**	**2021/22 Est. £000s**	**2022/23 Est. £000s**	**2023/24 Est. £000s**
Borrowing	1,100,000	1,070,000	1,050,000	1,030,000	1,020,000
Other Long Term Liabilities	150,000	270,000	270,000	270,000	270,000
Total	**1,250,000**	**1,340,000**	**1,320,000**	**1,300,000**	**1,290,000**

1.37 The Chief Finance Officer reports that these Authorised Limits are consistent with the Authority’s current commitments, existing plans and the proposals in this 2019/20 budget report for capital expenditure and financing, and in accordance with its approved Treasury Management Policy Statement and Practices.

Operational Boundary for total external debt

1.38 The proposed operational boundary is based on the same estimates as the authorised limit. However, it excludes the additional headroom which allows for unusual cash movements.

1.39 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 identified separately. Full Council will be 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.

1.40 Any such changes will be reported to the Cabinet at its next meeting following the change.

Table 8: Operational Boundary for External Debt

	2019/20 Est. £000s	2020/21 Est. £000s	2021/22 Est. £000s	2022/23 Est. £000s	2023/24 Est. £000s
Borrowing	550,000	535,000	525,000	515,000	510,000
Other Long Term Liabilities	130,000	220,000	220,000	22,000	220,000
Total	**680,000**	**755,000**	**745,000**	**735,000**	**730,000**

Prudential Indicators for Treasury Management

Adoption of the CIPFA Code of Practice for Treasury Management

1.41 The Authority has an integrated Treasury Management Strategy and has adopted the CIPFA Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes. North Tyneside Council has, at any point in time, a number of cash flows, both positive and negative, and manages its treasury position in terms of its borrowings and investments in accordance with its approved Treasury Management Strategy and Practices.

Upper limits on interest rate exposure 2021-2025

1.42 Full Council will be requested to set an upper limit on its fixed interest rate exposures for 2021/22 through to 2024/25 of 100% of its net outstanding principal sums.

1.43 Full Council will be requested to set an upper limit on its variable interest rate exposures for 2021/22 through to 2024/25 of 50% of its net outstanding principal sums.

1.44 The proposals to set upper and lower limits for the maturity structure of the Authority’s borrowings are as follows:

Table 9: Amount of projected borrowing that is fixed rate maturing in each period as a percentage of total projected borrowing that is fixed rate

	Upper Limit	Lower Limit
Under 12 months	50%	0%
12 months to 2 years	50%	0%
2 years to 5 years	50%	0%
5 years to 10 years	75%	0%
10 years to 20 years	100%	25%
20 years to 30 years	100%	25%
30 years to 40 years	100%	25%
40 years to 50 years	100%	25%