Prudential Indicators

The CIPFA Prudential and Treasury Management Codes of Practice

The two integrated Codes of practice have been developed as frameworks to support the decisions local authorities make for capital investment and borrowing decisions. Originally introduced in 2004, its latest update was in 2017. CIPFA is currently undertaking a consultation on the Codes including a review of the existing and need for additional indicators to support decision making. Compliance with the Code is a statutory requirement when carrying out their duties under Part I of the Local Government Act 2003 and the Local Authorities (Capital Finance and Accounting) (Wales) Regulations.

Objectives of the Code

The key objectives of the Codes are:

- To ensure that capital expenditure plans are affordable, prudent and sustainable
- That Treasury Management decisions are taken in accordance with good professional practice
- That local strategic planning, asset management planning and proper option appraisal are supported
- To provide a clear and transparent framework to ensure accountability.

CIPFA required Prudential Indicators to be produced

The indicators required are shown below, with further explanation as to their meaning:

1(a). External Debt - Operational Boundary (See Treasury Strategy)

The most likely, prudent view of the level of gross external indebtedness. External debt includes both borrowing and long term liabilities (e.g. finance leases). It encompasses all borrowing, whether for capital or revenue purposes. This indicator will be subject to the level and timing of borrowing decisions and so the actual level of borrowing can therefore be below or above this initial estimate. However what cannot be breached without a further report to Council is the authorised borrowing limit.

1(b). External Debt - The Authorised Limit (See Treasury Strategy)

The upper limit on the level of gross external indebtedness, which must not be breached without Council approval. It is the worst-case scenario. It reflects the level of borrowing which, while not desired, could be afforded but may not be sustainable. Any breach must be reported to the executive decision making body, indicating the reason for the breach and the corrective action undertaken or required to be taken. This limit is a statutory limit required to be set by the Council under Section 3(1) of the Local Government Act 2003.

1(c). External Debt - Actual External Debt (See Treasury Strategy)

The indicator for actual external debt will not be directly comparable to the operational boundary and authorised limit, since the actual external debt will reflect the actual position at one point in time.

2. Capital Financing Requirement (CFR) (See Capital Strategy)

The Capital Financing Requirement (CFR) replaced the 'Credit Ceiling' measure of the Local Government and Housing Act 1989. It measures an authority's underlying need to borrow or use other long-term liabilities, to pay for capital expenditure.

3. Capital Expenditure (See Capital Strategy)

The level of capital expenditure incurred and likely to be incurred in future years. This is to be based on an accruals basis and on the definition of capital expenditure.

4. Gross External Borrowing and the Capital Financing Requirement (See Treasury Strategy)

The level of external borrowing is required to be compared to the Capital Financing Requirement which represents the underlying need to borrow. Requires that borrowing in the medium term can only be for capital purposes.

5. Maturity Structure of Borrowing (See Treasury Strategy)

Local Authority debt portfolios consist of a number of loans with differing maturities. Setting limits assists in ensuring any new borrowing in particular when combined with existing borrowing does not result in large concentrations of borrowing maturing in a short period of time.

6. Principal sums invested for greater than one year (See Treasury Strategy)

This indicator measures the exposure of a local authority to investing for periods of greater than one year.

7. Ratio of Financing Costs to Net Revenue Stream (See Capital Strategy)

This indicator is a measure of affordability of historic and future capital investment plans. It identifies the trend in the cost of capital financing which include:

- interest payable on borrowing and receivable on investments
- penalties or any benefits receivable on early repayment of debt
- prudent revenue budget provision for repayment of capital expenditure paid for by borrowing
- reimbursement of borrowing costs from directorates in respect of Invest to Save/Earn schemes.

This is calculated for the General Fund and Housing Revenue Account. For the General Fund, the net revenue stream is the amount to be met from non-specific Welsh

Government grants and Council Tax, whilst for the HRA it is the amount to be met from rent payers. An increasing ratio indicates that a greater proportion of the Council's budget is required for capital financing costs over the planned Capital Programme period.

It should be noted that these figures include a number of assumptions such as:

- no new approvals of additional borrowing apart from that currently proposed over the period of the programme
- estimated interest rates
- the level of internal borrowing and timing of external borrowing decisions and capital expenditure
- the total level of the Welsh Government revenue support etc. which can fluctuate due to transfers in or out of the settlement
- Invest to Save / Earn schemes do perform as intended over the period identified in the initial proposal for investment.

Locally determined Prudential Indicators

8. Capital financing costs expressed as a ratio of Controllable Budget – General Fund (See Capital Strategy)

Whilst the indicator above is required by the Prudential Code, it has a number of limitations:

- it does not take into account the fact that some of the Council's revenue budget cannot be directly influenced such as schools delegated budgets, Fire Levy and Council Tax Reduction Scheme payments
- it is impacted by transfers in and out of the Settlement
- it includes investment income which is highly unpredictable, particularly in future years.

Although there may be short-term implications, Invest to Save/Earn schemes are intended to be net neutral on the capital financing budget. However, there are risks that the level of income, savings or capital receipts anticipated from such schemes will be delayed or not materialise and would have a detrimental long term consequence on the revenue budget. This requires careful monitoring when considering future levels of additional borrowing. Accordingly an additional local indicator is calculated for the General Fund to support decision making showing the ratio of capital financing costs of the Council expressed as a percentage of its controllable budget and excluding treasury investment income.

9. Capital Financing Requirement (Debt) to Net Revenue Stream – (See Capital Strategy)

This ratio shows the amount of debt proportionate to Net Revenue Stream and is an indicator of financial sustainability. It helps to explain the relationship of debt to annual resources available to deliver services.