

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 2021 following a review. This included the need for additional indicators to support decision making, to be considered and introduced in 2023/24. 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) shows the difference between the Authority's capital expenditure and the revenue or capital resources set aside to finance that spend. 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 rather than revenue or speculative 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. Liability Benchmark (See Treasury Strategy)

The Liability Benchmark is the Net Borrowing Requirement of a local authority plus a liquidity allowance. In its simplest form, it is calculated by deducting the amount of investable resources available on the balance sheet (reserves, cash flow balances) from the amount of outstanding external debt and then adding the minimum level of investments deemed required to manage day-to-day cash flow.

CIPFA recommends that the optimum position for external borrowing should be at the level of the Liability Benchmark (i.e, all balance sheet resources should be used to maximise internal borrowing). If the outputs show future periods where external loans are less than the Liability Benchmark, then this indicates a borrowing requirement thus identifying where the authority is exposed to interest rate, liquidity and refinancing risks. Conversely where external loans exceed the Liability Benchmark then this will highlight an overborrowed position which will result in excess cash in the organisation requiring investment thus exposing the authority to credit and reinvestment risks and a potential cost of carry. The treasury

strategy should explain how the treasury risks identified by the Liability Benchmark are to be managed over the coming years.

The Authority is required to estimate and measure the Liability Benchmark for the forthcoming financial year and the following two financial years, as a minimum. CIPFA strongly recommends that the benchmark is produced for at least 10 years and should ideally cover the full debt maturity profile of a local authority.

7. 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 and supports an assessment of ensuring cash is available to make payments when needed.

8. 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

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.