TELFORD & WREKIN COUNCIL

CABINET – 17TH FEBRUARY 2022
COUNCIL – 3RD MARCH 2022

2022/23 PRUDENTIAL INDICATORS

REPORT OF THE CHIEF FINANCE OFFICER (DIRECTOR: FINANCE & HUMAN RESOURCES)

LEAD CABINET MEMBER – CLLR RAE EVANS

PART A – SUMMARY REPORT

1. Summary of Main Proposals

1.1 To consider the prudential indicators for 2022/23 to 2024/25 required under the Prudential Code of Capital Finance in Local Authorities and to approve the indicators for 2022/23.

2. RECOMMENDATIONS

2.1 Members are asked to

1. Approve the prudential indicators proposed in this report.

3. SUMMARY IMPACT ASSESSMENT

COMMUNITY IMPACT	Do these proposals contribute to specific priority plan objectives?	
	Yes	The prudential indicators form part of the Council's Medium Term Financial Strategy (MTFS) and the overall budget and policy framework which is integral to ensuring that available resources are used as effectively as possible in delivering all corporate priority outcomes.
	Will the proposals impact on specific groups of people?	
	No	
TARGET COMPLETION / DELIVERY DATE	Prudential Indicators have to be set annually under the Local Government Act 2003.	
FINANCIAL / VALUE FOR MONEY IMPACT	Yes	Where appropriate these are detailed in the body of the report.

LEGAL ISSUES	Yes	Under s.15 Local Government Act 2003, local authorities are required to have regard to any statutory guidance. CIPFA's Prudential Code for Capital Finance in Local Authorities is considered to be mandatory guidance for the purpose of the LGA 2003 and sets out that prudential indicators must be set annually. RP 14/01/22
OTHER IMPACTS, RISKS AND OPPORTUNITUES	Yes	The opportunities and risks associated with the report have been identified and assessed. Arrangements will be put in place to manage the risks and maximise the opportunities that have been identified.
IMPACT ON SPECIFIC WARDS	No	

PART B – ADDITIONAL INFORMATION

4. Summary

4.1 The Prudential System was introduced from 1 April 2004. Under the Prudential System the Council has to approve Prudential Indicators annually and these are contained in this report.

5. The CIPFA Prudential Code

5.1 Following extensive consultation, CIPFA published revised codes on 20th December 2021. The 2021 publication of the Prudential Code applies with immediate effect, except that authorities may defer introducing the revised reporting requirements until the 2023/24 financial year should they wish as part of a soft launch. The revised reporting requirements, as detailed below, include changes to the capital strategy, prudential indicators and investment reporting. The general ongoing principles of the revised Prudential Code, including the requirement that an authority must not borrow to invest primarily for financial return, apply with immediate effect.

The Treasury Management in the Public Services: Code of Practice (CIPFA, 2021) and the accompanying Guidance Notes set out good practice in treasury management and are complementary to this Code.

The Local Government Act 2003 requires the Authority to have regard to the Chartered Institute of Public Finance and Accountancy's Prudential Code for Capital Finance in Local Authorities (2021 Edition) (the Prudential Code) when determining how much money it can afford to borrow. The objectives of the Prudential Code are to ensure, within a clear framework, that the capital investment plans of local authorities are affordable, prudent and sustainable, and that treasury management decisions are taken in accordance with good professional practice.

5.2 The general approach of the code is to require the Council to set estimates and limits on its borrowing and features associated with borrowing. The underlying philosophy is that the Council should set limits that ensure borrowing is affordable in the medium to long term. Affordability is determined by the overall amount of borrowing and the interest rate at which it is done. Because borrowing is only permissible (and will remain so) for capital expenditure local authorities have traditionally borrowed at longer term fixed rates of interest (i.e. over 1 year). This helps ensure stability over the medium term; for example a variable rate loan currently at 2.5% may be less attractive than a fixed rate loan at 2.8% if there is thought to be a reasonable possibility that variable rates will rise above 3.2% within a year. To help ensure financial stability the code requires authorities to consider the structure of their borrowing.

5.3 The code also requires authorities with significant investments to set indicators associated with lending money.

5.4 Practically the remaining paragraphs of this section consider the indicators and recommend what the indicators should be for 2022/23. In most cases indicators have to be set for 3 financial years ahead, so figures are also provided for 2023/24 and 2024/25. In proposing these indicators a pragmatic approach has been taken; i.e. known Council plans (including the present treasury structure) have been considered therefore, this set of proposed indicators is consistent with the assumptions used throughout the suite of MTFS reports.

5.5 For each indicator, ***the CIPFA requirements of the code are set out in bold italics.*** The limits proposed by the Chief Finance Officer for 2022/23 are then set out. An explanation is provided, unless the indicator and limits are completely self-explanatory.

6. Prudential Indicators of Affordability – Ratio Affordability Measure

The local authority will estimate for the forthcoming financial year and the following two financial years the ratio of financing costs to net revenue stream. This prudential indicator shall be referred to as estimates of ratio of financing costs to net revenue stream.

6.1 In Telford & Wrekin's case this indicator makes more sense if Local Government Reorganisation (LGR) debt paid over to Shropshire Council is included.

	Year 1 2022/23	**Year 2 2023/24**	**Year 3 2024/25**
Ratio of financing cost to net revenue stream	7.33%	8.81%	9.52%

6.2 The indicator has been calculated as debt interest costs divided by budget requirement for the general fund element. The general fund indicator above shows a slight increase in the ratio between 2022/23 and 2024/25 (this broadly matches the expected prudential borrowing which is noted in 10.1).

7. Prudential Indicators of Affordability – Incremental Housing Rent Affordability Measures

7.1 This Indicator does not apply to Telford & Wrekin Council as the Council does not operate council housing through a "Housing Revenue Account".

8. Estimates of Capital Financing Requirement

The local authority will make reasonable estimates of the total capital financing requirement at the end of the forthcoming financial year and the following two years. These prudential indicators shall be referred to as:

Estimate of capital financing requirement as at the end of years 1, 2 and 3.

8.1 The capital financing requirement is a concept in the Prudential System, but can simply be understood as the Council's underlying need to borrow money over the long term. The code requires that the figure is calculated gross, to include debt that is paid for by other authorities following Local Government Reorganisation (LGR), so in Telford & Wrekin's case, these figures have limited meaning, and locally the indicator needs adjusting for LGR debt.

8.2 The table below shows the estimated cumulative **Capital Financing Requirement (CFR)** at a point in time. These estimates include the impact of the Public Finance Initiative.

	31/03/22 £m	**31/03/23 £m**	**31/03/24 £m**	**31/03/25 £m**
Estimated Total CFR	505.7	601.8	671.1	682.9

8.3 The movement in the CFR is consistent with other planning assumptions.

8.4 The purpose of the **Gross Debt and Capital Financing Requirement** is to highlight a situation where the Council is planning to borrow in advance of need. If these figures exceed CFR (which they don't) they would indicate we are borrowing in advance of need.

	31/03/22 £m	**31/03/23 £m**	**31/03/24 £m**	**31/03/25 £m**
Estimated Outstanding Borrowing (at nominal value)	301.4	401.7	475.4	492.0
Other long term Liabilities	50.9	47.9	44.5	41.1
Gross Debt	352.3	449.6	519.9	533.1

9. Treasury Management Prudential Indicators

9.1 The Council adopted the revised CIPFA Code of Practice for Treasury Management in Public Services at its meeting in March 2010. Treasury Management Practices (TMPs) have been established by the Chief Finance Officer in line with the advice of our Treasury Advisors and are kept up to date with support from our Treasury Advisors. Although not a formal indicator, the Council must have regard to the Treasury Management Code.

10. Capital Expenditure and Capital Commitments Prudential Indicators

The local authority will make reasonable estimates of the total of capital expenditure that it plans to incur during the forthcoming financial year and at least the following two financial years. These prudential indicators shall be referred to as:

Estimate of total capital expenditure to be incurred in years 1, 2 and 3

10.1 The budget and capital programme report to Council for 2022/23 identifies programmed capital schemes, and subsequent year's capital needs. The estimates of capital expenditure to be incurred are therefore;

	2022/23 £m	**2023/24 £m**	**2024/25 £m**
Prudential Borrowing	100.286	73.732	16.604
Grant Funded	25.787	8.668	0.000
Revenue / External	10.705	0.380	0.000
Capital Receipts	2.800	5.500	0.500
Total	**139.578**	**88.280**	**17.104**

It is only the row relating to prudential borrowing that impacts on prudential indicators. These figures include further investment in NuPlace, the Council's wholly owned Housing Company, and Property Investment Portfolio both of which should generate returns for the Council well in excess of the associated debt charges and in addition to the significant community benefits that these schemes provide.

After the year-end, the actual capital expenditure incurred during the financial year will be recorded. This prudential indicator will be referred to as:

Actual capital expenditure

10.2 Actual capital expenditure for 2020/21: £57.710m

10.3 Estimated capital expenditure 2021/22: £73.309m

11. External Debt Prudential Indicators

The local authority will set for the forthcoming financial year and the following two financial years a prudential limit for its total external debt, gross of investments, separately identifying borrowing from other long term liabilities. This prudential indicator shall be referred to as:

<u>Authorised limit for external debt</u> = authorised limit for borrowing + authorised limit for other long term liabilities for years 1, 2 and 3.

11.1 The recommended Authorised Limit for External Debt for:

Authorised Limit	**2022/23 £m**	**2023/24 £m**	**2024/25 £m**
Borrowing	495.0	575.0	595.0
Other Long Term Liabilities	64.0	54.0	54.0

11.2 This limit represents the maximum amount the Council may borrow at any point in time in the year. It has to be set at a level the Council considers is "prudent". (This limit is analogous to the limit on borrowing set out in section 44 of the 1989 Act). Because it is ultra vires to exceed, the authorised limit must be set so as to avoid circumstances in which the Council would need to borrow more money than this limit.

11.3 Other long term liabilities include items that would appear on the balance sheet of the Council that are analogous to borrowing. For example, the capital cost of leases would be included.

12. Operational Boundary

The local authority will also set for the forthcoming financial year and the following two years an operational boundary its total external debt, gross of investments, separately identifying borrowing from other long term liabilities. This prudential indicator shall be referred to as the:

<u>Operational Boundary</u> = operational boundary for borrowing + operational boundary for other long term liabilities for years 1, 2 and 3.

12.1 The operational boundary is a measure of the maximum amount that the Council would normally borrow at any time during the year. The code recognises that circumstances might arise when the boundary might be exceeded temporarily, but suggest a sustained or regular pattern of borrowing above this level ought to be investigated, as a potential symptom of a more serious financial problem.

12.2 The Recommended Operational boundary for External debt is:

Operational Boundary	2022/23 £m	2023/24 £m	2024/25 £m
External Debt	475.0	555.0	575.0
Other Long Term Liabilities	60.0	50.0	50.0

13. Interest Rate Exposure

The local authority will set, for the forthcoming year and the following two years, limits to its <u>exposures</u> to the effects of changes in interest rates. These prudential indicators will relate to both fixed interest rates and variable interest rates and will be referred to respectively as the upper limits on fixed and variable interest rate exposures.

13.1 There is no requirement in the code to set lower limits; however, given the risks associated with having excessively high relatively short fixed, or variable rate borrowing, it is suggested that lower limits are set locally for longer maturing fixed rate borrowing.

13.2 Variable rate exposures

Borrowing that is at variable rates LESS Investments that are variable rate investments

The limits proposed are as follows;

	2022/23	2023/24	2024/25
Net variable limit	70%	70%	70%

13.3 We have also set a local indicator for setting a maximum exposure for variable rates as a percentage of total investment plus total debt. The limit proposed would be as follows;

	2022/23	2023/24	2024/25
Upper limit	70%	70%	70%

13.6 Fixed Interest Rate Exposure

The local authority will set, for the forthcoming year and the following two years, both upper and lower limits for its exposure to <u>fixed interest rate risk</u> calculated as follows and each expressed as total borrowing less total investments:

Fixed interest rate exposures
Borrowing that is at fixed rates LESS Investments that are fixed rate investments

Expressed as a percentage or absolute of total borrowing less investments.

13.7 The limits (expressed as an absolute of total fixed borrowing less total fixed investments) proposed are as follows:

Fixed Rate Risk	2022/23	2023/24	2024/25
Upper limit	100%	100%	100%
Lower limit	70%	70%	70%

In principle, it may be necessary / desirable for all borrowing at a point in time to be at a fixed rate. The lower limit is effectively the counterpart to the upper limit for variable rate exposure.

14. Prudential limits for the maturity structure of fixed rate borrowing

The local authority will set for the forthcoming year both upper and lower limits with respect to the maturity structure of its borrowing, calculated as follows

Amount of projected borrowing that is fixed rate maturing in each period Expressed as a Percentage of Total projected borrowing that is fixed rate at the start of the period*, where the periods in question are*

- ***Under 12 months***
- ***1 year and within 2 years***
- ***2 years and within 5 years***
- ***5 years and within 10 years***
- ***10 years and within 20 years***
- ***20 years and within 30 years***
- ***30 years and within 40 years***
- ***40 years and within 50 years***
- ***50 years+***

14.1 The proposed prudential limits are as follows;

Maturity	Lower Limit %	Upper Limit %
Under 12 months	0	70
1-2 years	0	30
2-5 years	0	50
5-10 years	0	75
10-20 years	0	75
20-30 years	0	75
30-40 years	0	100
40-50 years	0	100
Over 50 years	0	100

14.2 Under the investment guidance issued by MHCLG the Council needs to set indicators for ***<u>principal sums invested for periods longer than 1 year</u>*.** It is recommended that we set the following limit

Maximum principal investment that can be invested for more than 1 year

	2022/23	2023/24	2024/25
Upper limit	95%	95%	95%

15. Financial Implications

15.1 The prudential indicators provide a framework for 2022/23 in which the Council conducts its treasury activities, consistent with good treasury risk management.

15.2 The code indicates that “in all cases, the process of setting prudential indicators for treasury management should be accompanied by a clear and integrated forward treasury management strategy, and a recognition of the pre-existing structure of the authority’s borrowing and investment portfolios.” The indicators proposed here take account of the existing structure of borrowing and all reasonable restructuring activity that might occur.

15.3 In setting or revising its prudential indicators, the Council is required to have regard to the following matters:

- service objectives, e.g. strategic planning for the authority,
- stewardship of assets, e.g. asset management planning,
- value for money, e.g. option appraisal,
- prudence and sustainability, e.g. risk, implications for external debt and whole life costing,
- affordability, e.g. implications for council tax, and
- practicality, e.g. achievability of the forward plan.

The first 3 items are largely considered in the current arrangements as part of the asset management planning / corporate capital strategy processes. Item 4 is inherent to the prudential indicator setting process and Items 5 and 6 in financial terms have been taken account of by the Chief Finance Officer in presenting the budget.

16. Background Papers

Local Government Act 2003
CIPFA Prudential Code for Capital Finance in Local Authorities
Guidance on Local Authority Investments

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