ITEM 6(d)

NORTH YORKSHIRE COUNTY COUNCIL

EXECUTIVE

30 January 2018

REVISION OF PRUDENTIAL INDICATORS

Report of the Corporate Director – Strategic Resources

1.0 PURPOSE OF THE REPORT

1.1 To recommend to the County Council an updated set of Prudential Indicators for the period 2018/19 to 2020/21.

2.0 BACKGROUND

2.1 The current Capital Finance system introduced is underpinned by the **CIPFA Prudential Code for Capital Finance in Local Authorities**. In order to ensure that capital spending plans are affordable, prudent and sustainable, this Code requires every local authority to set a range of Prudential Indicators

(a) as part of the Revenue Budget process, and
(b) before the start of the financial year

2.2 The Prudential Indicators for 2017/18, covering the period up to 2019/20, were initially approved by the County Council on 15 February 2017 following recommendations of the Executive on 31 January 2017.

2.4 As part of the 2018/19 Budget process, a fresh set of Indicators for the period up to 2020/21 now needs to be considered and approved.

2.5 This Report should be read in conjunction with the separate report on the agenda regarding Treasury Management.

3.0 PROPOSED PRUDENTIAL INDICATORS FOR 2018/19 TO 2020/21

3.1 **Appendix A** to this Report sets out the proposed updated Prudential Indicators with the addition of a further year 2020/21. This Appendix sets out every Prudential Indicator in terms of:

(a) the current Indicators (to 2019/20) approved by County Council on 15 August 2017

(b) a revised set of Indicators with the addition of 2020/21

(c) appropriate comments on each Indicator including reasons for any significant variations

3.2 In general, the proposed Indicators reflect a number of common factors including

(a) the latest Capital Plan update to 31 December 2017 (Quarter 3 2017/18)

(b) updated financing of the Capital Plan reflecting (a) above, together with latest forecasts for capital receipts

(c) updated capital financing costs reflecting (a) and (b) above.

3.3 All the Prudential Indicators relating to external debt are based on the assumption that annual capital borrowing requirements for the years 2018/19 to 2020/21 will be taken externally each year. However, consideration will be given to delaying external borrowing throughout this period and funding annual borrowing requirements from revenue cash balances (i.e. running down investments). This has the potential for achieving short term revenue savings and also has the benefit of reducing investment exposure to credit risk.

3.4 In making its decision on the Revenue Budget, the County Council is asked to note that the Authorised Limit for external debt determined for 2018/19 (- see **Appendix A**) will be the statutory limit determined under Section 3 (1) of the Local Government Act 2003; this statutory requirement means that a local authority shall determine and keep under review how much money it can afford to borrow in a given financial year.

4.0 RECOMMENDATIONS

4.1 That the Executive recommends to the County Council that it

(i) approves the updated Prudential Indicators for 2018/19 to 2020/21 as set out in **Appendix A**

(ii) approves an Authorised Limit for External Debt of £348.9m in 2018/19 under Section 3(1) of the Local Government Act 2003 (**paragraph 3.4)**.

G FIELDING
Corporate Director – Strategic Resources

Background Documents

Prudential Code and related working papers - contact Karen Iveson, (01609) 535664

County Hall
Northallerton

22 January 2018

PRUDENTIAL INDICATORS FOR PERIOD 2018/19 to 2020/21
(EXECUTIVE – 31 January 2017)

CAPITAL EXPENDITURE & EXTERNAL DEBT INDICATORS	Comment
1 Estimated Ratio of capital financing costs to the net Revenue Budget (a) *Formally Required Indicator* This reflects capital financing costs (principal plus interest) on external debt plus PFI and finance leasing charges, less interest earned on the temporary investments of surplus cash balances. The estimated ratios of financing costs to the net Revenue Budget for the current and future years, and the actual figure for 2016/17 are as follows:	The estimates of financing costs include current Capital Plan commitments based on the latest Capital Plan, and are as reflected in the 2018/19 Revenue Budget and MTFS. The updated figures up to 2020/21 reflect the net effect of a range of factors, principally (a) savings being achieved through the on-going policy of financing capital borrowing requirements internally from cash balances (b) variations in the level of annual borrowing requirements resulting from a range of factors (c) variations in borrowing costs (interest plus a revenue provision for debt repayment) reflecting latest interest rate forecasts to 2020/21 (d) variations in interest earned on cash balances resulting from continuing current historically low interest rates but partially offset by continuing higher levels of cash balances (formal Indicator only) (e) changes to the 'net budget' element of this calculation, particularly as a result of funding reductions and consequential savings requirements.

Year	Executive 15 Aug 2017		Update for 2018/19	
	Basis	%	Basis	%
2016/17	actual	7.5	actual	7.5
2017/18	estimate	7.2	actual	7.0
2018/19	estimate	6.8	estimate	6.5
2019/20	estimate	6.4	estimate	6.1
2020/21	estimate	N/A	estimate	4.7

APPENDIX A

CAPITAL EXPENDITURE & EXTERNAL DEBT INDICATORS	Comment
(b) *Local Indicator* This Local Indicator reflects a policy decision to cap capital financing costs to 10% (previously 11%) of the net annual Revenue Budget. The Indicator is different to the formally required Indicator at (a) above in that it only reflects the cost components of interest on external debt plus lost interest on internally financed capital expenditure, together with a revenue provision for debt repayment. Unlike the formally required PI it does not reflect interest earned on surplus cash balances or PFI / Finance leasing charges	See comments for formal indicator at 1 (a) above.

Year	Executive 15 Aug 2017		Update for 2018/19	
	Basis	%	Basis	%
2016/17	actual	7.7	actual	7.7
2017/18	estimate	7.3	probable	7.2
2018/19	estimate	7.0	estimate	6.8
2019/20	estimate	6.7	estimate	6.5
2020/21	estimate	N/A	estimate	5.2

Prudential Indicator	Comment

2 Capital Expenditure - Actual and Forecasts

The actual capital expenditure that was incurred in 2016/17 and the estimates of capital expenditure to be incurred for the current and future years are:

Year	Executive 15 Aug 2017 Basis	£m	Update for 2018/19 Basis	£m
2016/17	actual	110.1	actual	110.1
2017/18	estimate	139.9	probable	119.3
2018/19	estimate	103.7	estimate	117.3
2019/20	estimate	75.1	estimate	75.6
2020/21	estimate	N/A	estimate	76.6

The above estimates and those for certain other Prudential Indicators incorporate a number of figures that are based on:-

(a) the latest Capital Plan update to 31December 2016 (Q3 2017/18)

(b) expenditure on fixed assets funded directly from the Revenue Budget and not included in the Capital Plan

(c) forecast expenditure slippage between years

(d) various other refinements

Comment

The updated figures for 2017/18 to 2020/21 reflect the following variations compared with the figures submitted to Executive.

(a) the Government's Capital allocations announced to date as part of the 2018/19 Provisional Local Government Settlement.

(b) a number of additional provisions and variations to existing provisions which are self funded from capital grants and contributions and revenue contributions (including the Pending Issues Provision)

(c) capital expenditure re-phasing between years

(d) the addition of a further year 2020/21

(e) various other approvals and refinements to the Capital Plan up to 31 December 2016 (Q3 2017/18).

Prudential Indicator	Comment
3 Capital Financing Requirement	

Actuals and estimates of the Capital Financing Requirement (CFR) at the defined year ends are as follows:

Date	Executive 15 Aug 2017 Basis	Borrowing	Other Long Term Liabilities (PFI etc)	Total	Update for 2018/19 Basis	Borrowing	Other Long Term Liabilities (PFI etc)	Total
		£m	£m	£m		£m	£m	£m
31 Mar 17	actual	322.0	5.3	327.3	Actual	322.0	5.3	327.3
31 Mar 18	estimate	315.0	5.1	320.1	Probable	307.0	5.1	312.1
31 Mar 19	estimate	302.8	4.7	307.5	Estimate	295.3	4.7	300.0
31 Mar 20	estimate	297.9	4.4	302.3	Estimate	283.4	4.4	287.8
31 Mar 21	estimate	N/A	N/A	N/A	Estimate	272.3	4.0	276.3

The CFR measures the underlying need for the County Council to borrow for capital purposes. In accordance with best professional practice, the County Council does not earmark borrowing to specific items or types of expenditure. The County Council has an integrated treasury management approach and has adopted the CIPFA Code of Practice for Treasury Management. The County Council has, at any point in time, a number of cashflows, both positive and negative, and manages its treasury position in terms of its overall borrowings and investments in accordance with its approved Annual Treasury Management Strategy. In day to day cash management, no distinction is made between revenue and capital cash. External borrowing arises as a consequence of all the financial transactions of the County Council as a whole and not simply those arising from capital spending. In contrast, the CFR Indicator reflects the County Council's underlying need to borrow for capital purposes only.

Comment:

The updated figures recommended for approval as part of the 2018/19 Budget process reflect the following main variations compared with the previous figures approved by the Executive.

(a) capital expenditure re-phasing between years that is funded from borrowing

(b) capital receipts re-phasing between years (including Company Loan repayments) that affects year on year borrowing requirements

(c) addition of 2020/21 including forecast new Prudential borrowing for bids previously agreed

(d) variations in the level of the Corporate Capital pot which is used in lieu of new borrowing until the pot is required

(e) variations in the annual Minimum Revenue Provision (MRP) for debt repayment which arise from the above

(f) various other refinements.

Prudential Indicator	Comment
4 Gross Debt and the Capital Financing Requirement The Prudential Code emphasises that in order to ensure that over the medium term debt will only be for a capital purpose, the County Council should ensure that debt does not, except in the short term, exceed the total of the capital financing requirement in the previous year (2017/18), plus the estimate of any additional capital financing requirement for the current (2018/19) and next two financial years (2019/20 and 2020/21). If, in any of these years, there is a reduction in the capital financing requirement, this reduction should be ignored in estimating the cumulative increase in the capital financing requirement which is used for comparison with gross external debt. This Prudential Indicator is referred to as gross debt and the comparison with the capital financing requirement (**Indicator 4**) and is a key indicator of prudence. The Corporate Director – Strategic Resources has previously reported that the County Council had no difficulty in meeting this requirement up to 2016/17 nor are any difficulties envisaged for the current or future years covered by this PI update to 2020/21. For subsequent years, however, there is potential that the County Council may not be able to comply with the new requirement as a result of the potential for the annual Minimum Revenue Provision (MRP) reducing the Capital Financing Requirement below gross debt. This potential situation will be monitored closely. This opinion takes into account spending commitments, existing and proposed Capital Plans and the proposals in the separate Revenue Budget 2018/19 and Medium Term Financial Strategy report.	This Prudential Indicator was changed in 2016/17 to reflect the comparison of gross debt (external debt plus other long term liabilities less debt administered on behalf of the Police Authority) with the Capital Financing Requirement (CFR). The comparator debt figure had previously been net debt which was gross debt less investments. The Prudential Code requires that where there is a significant difference between the gross debt and the gross borrowing requirement, as demonstrated by the CFR, then the risks and benefits associated with this strategy should be clearly stated in the annual Treasury Management Strategy. The County Council's gross debt figure is currently significantly below the CFR figures shown in **Indicator 4** because of annual capital borrowing requirements being funded internally from cash balances (i.e. running down investments) rather than taking out new external debt. This situation, however, could be reversed in future as a result of two key factors: (i) externalising some or all of the internally financed CFR together with (ii) the potential for the annual Minimum Revenue Provision (MRP) for debt repayment reducing the CFR below gross debt because the debt cannot readily be prematurely repaid without incurring significant penalties (premiums). This potential situation will be monitored carefully by the Corporate Director – Strategic Resources.

Prudential Indicator	Comment
5 Authorised Limit for External Debt	
In respect of external debt, it is recommended that the County Council specifically approves the following Authorised Limits for its total external debt for the next three financial years.	The Corporate Director – Strategic Resources confirms that these authorised limits are consistent with the County Council's current commitments, existing Capital Plan and the financing thereof, the proposals in the respective 2018/19 Revenue Budget and Medium Term Financial Strategy, and with its approved Treasury Management Policy Statement.
The Prudential Code requires external borrowing and other long term liabilities to be identified separately.	The Corporate Director – Strategic Resources also confirms that the limits are based on the estimate of the most likely, prudent, but not worst case, scenario with sufficient headroom over and above this to allow for operational issues (eg unusual cash movements). To derive these limits a risk analysis has been applied to the Capital Plan, estimates of the capital financing requirement and estimates of cashflow requirements for all purposes.
The authorised limit for 2018/19 (£346.6m) will be the statutory limit determined under section 3(1) of the Local Government Act 2003.	The updated figures reflect a number of refinements which are common to the Capital Financing Requirement (see **Indicator 4** above) and Operational Boundary for External Debt (see **Indicator 7**). Explanations for these changes are provided under **Indicators 4 and 7** respectively.

Year	**Executive 15 Aug 2017**			**Update for 2018/19**		
	External Borrowing	**Other Long Term Liabilities**	**Total Borrowing Limit**	**External Borrowing**	**Other Long Term Liabilities**	**Total Borrowing Limit**
	£m	**£m**	**£m**	**£m**	**£m**	**£m**
2017/18	379.6	5.1	384.7	374.9	5.1	380.0
2018/19	346.5	4.7	351.2	344.2	4.7	348.9
2019/20	368.9	4.4	373.3	352.7	4.4	357.1
2020/21	N/A	N/A	N/A	362.8	4.0	366.8

Prudential Indicator	Comment
6 Operational Boundary for External Debt It is recommended that the County Council approves the following Operational Boundary for external debt for the same period. The proposed operational boundary for external debt is based on the same estimates as the Authorised Limit (ie **Indicator 6** above) but reflects an estimate of the most likely prudent, but not worst case, scenario without the additional headroom included within the Authorised Limit (to allow for eg unusual cash flows).	The Operational Boundary represents a key management tool for the in year monitoring of external debt by the Corporate Director – Strategic Resources. The updated figures reflect refinements which are common to the Capital Financing Requirement (**see Indicator 4 above**) together with (a) relative levels of capital expenditure funded internally from cash balances rather than taking external debt (b) loan repayment cover arrangements and the timing of such arrangements These two financing transactions affect external debt levels at any one point of time during the financial year but do not impact on the Capital Financing requirement.

Year	Executive 15 Aug 2017			Update for 2018/19		
	External Borrowing	**Other Long Term Liabilities**	**Total Borrowing**	**External Borrowing**	**Other Long Term Liabilities**	**Total Borrowing Limit**
	£m	**£m**	**£m**	**£m**	**£m**	**£m**
2017/18	359.6	5.1	364.7	354.9	5.1	360.0
2018/19	326.6	4.7	331.3	324.2	4.7	328.9
2019/20	348.9	4.4	353.3	332.7	4.4	337.1
2020/21	N/A	N/A	N/A	342.8	4.0	346.8

Prudential Indicator	Comment
7 Actual External Debt The County Council's actual external debt is set out below and consists of external borrowing plus other long term liabilities such as PFI and finance leases which are classified as external debt for this purpose.	The updated estimates reflect refinements which are common to the Capital Financing Requirement (**see Indicator 4 above**), together with the relative levels of capital expenditure internally funded from cash balances rather than taking external debt.

Year	Executive 15 Aug 2017				Update for 2018/19			
	Basis	Borrowing	Other Long Term Liabilities (PFI etc)	Total	Basis	Borrowing	Other Long Term Liabilities (PFI etc)	Total
		£m	£m	£m		£m	£m	£m
31 March 2017	actual	309.0	5.3	314.3	actual	309.0	5.3	314.3
31 March 2018	estimate	287.5	5.1	292.6	probable	287.5	5.1	292.6
31 March 2019	estimate	285.1	4.7	289.8	estimate	285.1	4.7	289.8
31 March 2020	estimate	263.1	4.4	267.5	estimate	263.1	4.4	267.5
31 March 2021	estimate	N/A	N/A	N/A	estimate	236.0	4.0	240.0

It should be noted that actual external debt is not directly comparable to the Authorised Limit (**Indicator 6 above**) and operational boundary (**Indicator 7 above**) since the actual external debt reflects a position at one point in time (ie at the end of each financial year).

Prudential Indicator	Comment
8 Limit of Money Market Loans (Local Indicator) Borrowing from the money market for capital purposes is to be limited to 30% of the County Council's total external debt outstanding at any one point in time. The actual position at 31 March 2017 was 6.5% (£20m out of a total of £309.0m) against the upper limit of 30%.	This limit was introduced as a new Local Prudential Indicator in 2009/10, although the 30% limit has featured as part of the Borrowing Policy section of the Annual Treasury Management and Investment Strategy for several years.

Prudential Indicator	Comment
9 Maturity Structure of Borrowing	

9 Maturity Structure of Borrowing

In accordance with the Code of Practice, the County Council sets upper and lower limits for the maturity structure of County Council borrowings as follows.

The amount of projected borrowing maturing in each period as a percentage of total projected borrowing that is fixed rate:

Period	Lower Limit %	Upper Limit %	Memo item - actual at 1 April 17 %	Memo item - actual at 1 April 18 %
under 12 months	0	50	6	0
12 months & within 24 months	0	15	0	7
24 months & within 5 years	0	45	20	20
5 years & within 10 years	0	75	9	3
10 years & within 25 years	10	100	8	9
25 years & within 50 years	10	100	56	60
			100	100

Comment

No changes to these limits approved by Executive on 15 February 2017 and reconfirmed on 8 November 2017 are proposed.

The lower limits of 10% for the periods 10 to 25 years and 25 to 50 years is designed to ensure that the County Council does not have the risk of having to repay all debt within a ten year period.

Prudential Indicator	Comment
10 Total Principal Sums Invested for periods longer than 365 days The 2018/19 aggregate limit of £40m for 'non specified' investments longer than 364 days is based on a maximum of 20% of 'core cash funds' being made available for such investments. The purpose of this prudential limit for principal sums invested for longer than 365 days is for the County Council to contain its exposure to the possibility of loss that might arise as a result of its having to seek early repayment or redemption of principal sums invested.	The County Council currently has no such investments that fall into this category. Prior to 1 April 2004, regulations generally prevented local authorities from investing for longer than 365 days. As a result of the new Prudential Regime however, these prescriptive regulations were abolished and replaced with Government Guidance from April 2004. This Guidance, which was updated from 1 April 2010, gives authorities more freedom in their choice of investments (including investing for periods longer than 365 days) and recognises that a potentially higher return can be achieved by taking a higher (ie longer term) risk. This flexibility requires authorities to produce an Annual Investment Strategy that classifies investments as either **Specified** (liquid, secure, high credit rating & less than 365 days) or **Non Specified** (other investments of a higher risk). Non Specified investments are perfectly allowable but the criteria and risks involved must be vigorously assessed, including professional advice, where appropriate. Therefore investments for 364 days+ are now allowable as a Non Specified investment under Government Guidance. The use of such investments is therefore now incorporated into the County Council's Annual Treasury Management and Investment Strategy.